TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., PETITIONERS,

vs.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 25, 1958
CERTIORARI GRANTED OCTOBER 13, 1958

SUPREME COURT OF THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Appendix to Appellants' Brief

IN UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

RELEVANT DOCKET ENTRIES—In Appeal No. 12299—
Civil Action No. 15229

May 12, 1953.	Complaint filed.
May 12, 1953.	Summons exit.
June 2, 1953.	Summons returned "on May 13, 1953 served Francis R. Smith and on May 21, 1953 served United States Attorney and on May 19, 1953 served Attorney General and Commissioner of Internal Revenue, both by registered mail, and filed.
June 5, 1953.	Appearance of Joseph G. Hildenberger, Esq., for defendant filed.
July 15, 1953.	Stipulation and Order of Court extending time for filing Answer to September 10, 1953 filed. Noted 7/16/53.
Sept. 16, 1953.	Stipulation and Order extending time for filing answer to 11/9/53 filed. 9/17/53 Noted.
Nov. 11, 1953.	Stipulation and Order extending time for filing answer to 1-8-54, filed. 11-12-53 Noted.
Jan. 8, 1954.	Answer filed.
Feb. 14, 1956.	Order to place on trial list filed.
Mar. 2, 1956.	Plaintiff's notice of taking deposition of J. William Wetter filed.

[fol. 2]

Mar. 2, 1956. Plaintiff's notice of taking deposition of James W. George, filed.

Mar. 26, 1956. Plaintiff's notice of taking deposition of James W. George filed.

Mar. 26, 1956. Plaintiff's notice of taking deposition of J. William Wetter filed.

May 15, 1956. Depositions of James H. George and J. William Wetter filed.

Nov. 29, 1956. Appearance of Charles I. Thompson, Esq. for Plaintiffs, filed.

Nov. 30, 1956. Trial — witness sworn. (Cont'd to 12/20/56)

Nov. 30, 1956. Stipulation of Facts filed.

Nov. 30, 1956. Pre-trial memorandum filed.

Dec. 14, 1956. Transcript of hearing of 11-30-56, filed.

Dec. 20, 1956. Trial—witness sworn.

Dec. 21, 1956. Trial concluded. CAV

Jan. 30, 1957. First supplemental stipulation of facts, filed.

Feb. 6, 1957. Transcript of testimony (Dec. 20 and 21, 1956) filed.

Feb. 13, 1957. Plaintiff's requests for findings of fact and conclusions of law filed.

May 10, 1957. Defendant's proposed findings of fact and conclusions of law (filed with Court 4-9-57), filed.

May 28, 1957. Opinion, Van Dusen, J., with findings of fact and conclusions of law, and Order in favor of Defendant, filed. 5-29-57 Noted & Notice Mailed.

[fol. 3]

May 28, 1957. Judgment in favor of Defendant, with costs, filed. 5-29-57 Noted & Notice Mailed.

June 13, 1957. Government's bill of costs, filed.

June 14, 1957. Notice of appeal by plaintiff's filed, copy mailed to H. K. Wood, Esq. 6-17-57.

June 14, 1957. Copy of Clerk's Notice to U. S. Court of Appeals, filed.

June 14, 1957. Bond for costs on appeal in the sum of $250.00 with Hartford Accident and Indemnity Company as surety filed.

July 5, 1957. Record transmitted to U. S. Court of Appeals.

Aug. 13, 1957. Defendant's bill of costs, filed.

Sept. 6, 1957. Plaintiffs' exceptions to Defendant's bill of costs and motion to stay taxation of costs pending appeal, filed.

IN UNITED STATES DISTRICT COURT

RELEVANT DOCKET ENTRIES—In Appeal No. 12300—
Civil Action No. 15230

May 12, 1953. Complaint filed.

May 12, 1953. Summons exit.

June 2, 1953. Summons returned "on May 13, 1953 served Francis R. Smith and on May 21, 1953 served United States Attorney, and on May 19, 1953 served Attorney General and Commissioner of Internal Revenue both by registered mail, and filed.

June 5, 1953. Appearance of Joseph G. Hildenberger, Esq., for defendant, filed.

[fol. 4]

July 15, 1953. Stipulation and Order of Court extending time for filing Answer to September 10, 1953 filed. Noted 7/16/53

Sept. 16, 1953.	Stipulation and Order extending time for filing answer to 11/9/53 filed. 9/17/53 Noted
Nov. 11, 1953.	Stipulation and Order extending time for filing answer, etc. to 1-8-54, filed. 11-12-53 Noted.
Jan. 8, 1954.	Answer filed.
Feb. 14, 1956.	Order to place case on trial list filed.
Nov. 29, 1956.	Appearance of Charles I. Thompson, Esq., for plaintiffs, filed. (#15229)
Nov. 30, 1956.	Trial—witnesses sworn (cont'd to 12/20/-56)
Nov. 30, 1956.	Stipulation of Facts filed. (#15229)
Dec. 14, 1956.	Transcript of hearing of 11-30-56, filed. (#15229)
Dec. 20, 1956.	Trial—witnesses sworn
Dec. 21, 1956.	Trial concluded. CAV
Jan. 30, 1957.	First supplemental stipulation of facts, filed. (#15229)
Feb. 6, 1957.	Transcript of testimony (Dec. 20 and 21, 1956) filed. (#15229)
Feb. 13, 1957.	Plaintiff's requests for findings of fact and conclusions of law filed. (#15229)
May 10, 1957.	Defendant's proposed findings of fact and conclusions of law (filed with Court 4-9-57), filed. (#15229)
[fol. 5] May 28, 1957.	Opinion, VanDusen, J., with findings of fact and conclusions of law, and Order in favor of Defendant, filed. 5-29-57 Noted & Notice Mailed. (#15229)
May 28, 1957.	Judgment in favor of Defendant, with costs, filed. 5-29-57 Noted & Notice Mailed.

June 13, 1957. Government's bill of Costs filed. (#15229)

June 14, 1957. Notice of appeal by plaintiffs filed, copy mailed to H. K. Wood, Esq. 6-17-57 (#15229)

June 14, 1957. Copy of Clerk's Notice to U. S. Court of Appeals, filed.

June , 1957. Bond for costs on appeal in the sum of $250.00 with Hartford Accident and Indemnity Company as surety filed. (#15229)

July 5, 1957. Record transmitted to U. S. Court of Appeals.

Aug. 13, 1957. Defendant's bill of costs, filed. (#15229)

Sept. 6, 1957. Plaintiffs' exceptions to Defendant's bill of costs and motion to stay taxation of costs pending appeal, filed.

IN UNITED STATES DISTRICT COURT

RELEVANT DOCKET ENTRIES—In Appeal No. 12301—Civil Action No. 15231

May 12, 1953. Complaint filed.

May 12, 1953. Summons exit.

June 5, 1953. Appearance of Joseph G. Hildenberger, Esq., for defendant filed.

[fol. 6]

June 17, 1953. Summons returned: "On 5-13-53 served F. R. Smith" and "on 5-21-53 served U. S. Attorney" and "On 5-20-53 served by Registered Mail upon Attorney General and Commissioner of Internal Revenue", and filed.

July 15, 1953. Stipulation and Order of Court extending time for filing Answer to September 10, 1953 filed. Noted 7/16/53.

Sept. 16, 1953.	Stipulation and Order extending time for filing answer to 11/9/53 filed. 9/17/53 Noted.
Nov. 11, 1953.	Stipulation and Order extending time for filing answer etc. to 1-8-54, filed. 11-12-53 Noted.
Jan. 8, 1954.	Answer filed.
Feb. 14, 1956.	Order to place case on trial list filed.
Nov. 29, 1956.	Appearance of Charles I. Thompson, Esq. for Plaintiffs, filed. (#15229).
Nov. 30, 1956.	Trial—witnesses sworn (cont'd to 12/20/56).
Nov. 30, 1956.	Stipulation of Facts filed. (#15229).
Nov. 30, 1956.	Pre-trial memorandum filed. (#15229).
Dec. 14, 1956.	Transcript of hearing of 11-30-56, filed. (#15229).
Dec. 20, 1956.	Trial—witnesses sworn.
Dec. 21, 1956.	Trial concluded. CAV.
Jan. 30, 1957.	First supplemental stipulation of facts filed. (#15229).
Feb. 6, 1957.	Transcript of testimony (Dec. 20 and 21, 1956) filed. (#15229).
[fol. 7]	
Feb. 13, 1957.	Plaintiff's requests for findings of fact and conclusions of law filed. (#15229).
May 10, 1957.	Defendant's proposed findings of fact and conclusions of law (filed with Court 4-9-57), filed. (#15229).
May 28, 1957.	Opinion, VanDusen, J., with findings of fact and conclusions of law, and Order in favor of Defendant, filed. 5-29-57 Noted & Notice Mailed. (#15229).

May 28, 1957. Judgment in favor of Defendant, with costs, filed. 5-29-57 Note & Notice Mailed.

June 13, 1957. Government's bill of costs, filed.

June 14, 1957. Notice of appeal by plaintiffs filed, copy mailed to H. K. Wood, Esq. 6-17-57 (#15229).

June 14, 1957. Copy of Clerk's Notice to U. S. Court of Appeals, filed.

June 14, 1957. Bond for costs on appeal in the sum of $250.00 with Hartford Accident and Indemnity Company as surety filed. (15229).

July 5, 1957. Record transmitted to U. S. Court of Appeals.

Aug. 13, 1957. Defendant's bill of costs, filed (#15229).

Sept. 6, 1957. Plaintiffs' Exceptions to Defendant's bill of costs and motion to stay taxation of costs pending appeal, filed.

[fol. 8]

IN UNITED STATES DISTRICT COURT

OPINION SUR PLEADINGS AND PROOF (INCLUDING ORDER)

(In All 3 Appeals.)

VAN DUSEN, J. May 28, 1957

FINDINGS OF FACT.

1. Plaintiffs Emory W. and Erma M. Parsons and Lawrence H. and Grace E. Parsons are individuals, resident in Orbisonia, Huntington County, Pa., and Howard H. and Martha Parsons are individuals, resident in Fort Littleton, Fulton County, Pa. (Stipulation of Facts).

2. Defendant Francis R. Smith is a resident in the Eastern District of Pennsylvania and was at all times relevant

hereto the duly appointed Collector of Internal Revenue for the First District of Pennsylvania, having entered office on May 1, 1945, and left office on November 11, 1952 (Stipulation of Facts).

3. Prior to January 1, 1943, Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons were members, together with their father, Alfred H. Parsons, in a partnership doing business under the name of A. H. Parsons & Sons. Effective January 1, 1943, plaintiffs Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons purchased the partnership interest of A. H. Parsons and formed a successor partnership doing business as equal partners under the name of Parsons Brothers. Plaintiff Lawrence H. Parsons withdrew from that partnership, effective as of December 31, 1948,[1] and plaintiffs Emory W. Parsons and [fol. 9] Howard H. Parsons thereafter continued to do business as equal partners under the name of Parsons Brothers. As hereinafter used, the term "Parsons" shall mean whichever of the three partnerships referred to in this paragraph as may be appropriate in the context (Stipulation of Facts and N. T. 4).

4. Plaintiffs Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons filed individual income tax returns for the years 1945, 1946 and 1947. Plaintiffs Emory W. Parsons and Erma M. Parsons, and plaintiffs Howard H. Parsons and Martha Parsons, filed joint income tax returns for the years 1948 and 1949. Plaintiffs Lawrence H. Parsons and Grace E. Parsons filed a joint income tax return for the year 1948 (Stipulation of Facts).

5. On the income tax returns in paragraph 4, plaintiff Emory W. Parsons for the years 1945, 1946 and 1947, and

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[1] When Lawrence H. Parsons left the partnership, no new agreement was made with Rockhill (N. T. 94) similar to the January 1, 1943, agreement when A. H. Parsons left such partnership, and a letter to Rockhill (P-4), accepted by Mr. Wetter on behalf of Rockhill (N. T. 52), served to give the new partnership all the rights, interests, and obligations of the former partnership (N. T. 50-3, 192 and see Exhibit D-21). Wetter testified that he had no recollection of being apprised of L. H. Parsons' leaving the partnership in 1949 and Rockhill just kept doing business with Parsons Brothers (N. T. 192 and see Exhibit D-28).

plaintiffs Emory W. Parsons and Erma M. Parsons for the years 1948 and 1949, paid federal income tax to defendant as follows:

1945	$ 6,457.96	($1,123.75 of such amount was paid to defendant's predecessor in office.)
1946	$13,529.66	
1947	$29,325.04	(Plus subsequent deficiency and interest payment of $3,372.45 and $767.39, respectively.)
1948	$34,464.04	(Plus subsequent deficiency and interest payment of $4,024.08 and $671.22, respectively.)
1949	$33,316.50	(Less refund unrelated to the issue in this case of $2,029.93.)

and timely filed with defendant claims for refund (Exhibits A to E), as follows:

[fol. 10]

1945	$2,139.17
1946	1,720.44
1947	6,688.05
1948	5,715.36
1949	5,630.26

(Stipulation of Facts).

6. On the income tax returns in paragraph 4, plaintiff Howard H. Parsons for the years 1945, 1946 and 1947, and plaintiffs Howard H. Parsons and Martha Parsons for the years 1948 and 1949, paid federal income tax to defendant as follows:

1945	$ 6,374.19	($1,100.30 of such amount was paid to defendant's predecessor in office.)
1946	$15,823.53	(Plus subsequent deficiency and interest payments of $10,838.06 and $2,334.94, respectively.)
1947	$31,339.01	(Plus subsequent deficiency and interest payments of $3,380.49 and $769.22, respectively.)

1948	$35,467.06	(Plus subsequent deficiency and interest payments of $4,085.82 and $681.51, respectively.)
1949	$34,097.58	(Less refund unrelated to the issue in this case of $2,029.93.)

and timely filed with defendant claims for refund (Exhibits A to E) as follows:

1945	$2,122.88
1946	2,913.64
1947	6,774.32
1948	5,761.66
1949	5,666.32

(Stipulation of Facts).

[fol. 11] 7. On the income tax returns in paragraph 4, plaintiff Lawrence H. Parsons for the years 1945, 1946 and 1947, and plaintiffs Lawrence H. Parsons and Grace E. Parsons for the year 1948, paid federal income tax to defendant as follows:

1945	$ 5,902.85	($990.69 of such amount was paid to defendant's predecessor in office.)
1946	$15,557.53	(Plus subsequent deficiency and interest payments of $10,747.81 and $2,315.74, respectively.)
1947	$34,944.94	(Plus subsequent deficiency and interest payments of $3,509.19 and $798.42, respectively.)
1948	$37,122.99	(Plus subsequent deficiency and interest payments of $4,187.71 and $698.51, respectively.)

and timely filed with defendant claims for refund (Exhibits A to D), as follows:

1945	$2,078.42
1946	2,895.81
1947	6,908.73
1948	5,814.22

(Stipulation of Facts).

8. The Commissioner of Internal Revenue notified plaintiffs by registered mail of the disallowance of the claims set forth in paragraphs 5, 6 and 7 (Stipulation of Facts).

9. The principal activities of Parsons from 1939 to the fall of 1942 were building highways or roads and some coal stripping. Presently, Parsons is engaged in coal stripping and drilling of gas wells (N. T. 5).

[fol. 12] 10. During the taxable years 1945 through 1949, Parsons was engaged in removing overburden and strip mining coal on the property of Rockhill Coal Company (hereinafter called "Rockhill") (Stipulation of Facts).

11. Parsons first stripped coal on Rockhill property in 1939, when they leased a tract known as the Fire Tower Tract for the purpose of strip mining thereon. Parsons was unable to sell the coal taken out because it was oxidized, but an analysis of it by Rockhill found that Rockhill could use it by mixing it with their deep mined coal (N. T. 14). Parsons surrendered the lease to Rockhill and the agreement of February 17, 1941 (Exhibit P-1), was made between these parties under which Parsons continued to strip the remaining coal on the Fire Tower Tract (N. T. 14-6, 94, 95, 151). Parsons finished stripping the Fire Tower Tract in 1943 (N. T. 16).

12. In February of 1942, Rockhill approached Parsons with a view toward entering into another contract to cover an additional area to be stripped by Parsons on Rockhill's land (plaintiffs' Request for Finding of Fact No. 20).

13. On February 27, 1942, a meeting was held at Rockhill's office in Robertsdale, Pa., at which plaintiff Emory W. Parsons, Mr. James George, General Manager of Rockhill, and Mr. Thomas F. Morgan, Mining Engineer of Rockhill (now deceased), were present (N. T. 14, 17, 155, 231, 232). At that meeting, using a large map on the wall of the office, the parties settled upon a particular area with respect to future stripping operations to be done by Parsons and agreed that a written agreement would be prepared by Mr. Morgan and later submitted to Mr. Parsons for his signature. A blueprint, which was attached to this

contract when written, delineated the area pointed to on the wall map (N. T. 17-8, 232).

[fol. 13] 14. An agreement dated March 2, 1942 (Exhibit P-2),[2] was prepared by Mr. Morgan following this meeting to cover the proposed area, and on several occasions after February 27 was presented by Mr. Morgan, in the presence of Mr. George, to Mr. E. Parsons for signature. Mr. Parsons did not sign the agreement (N. T. 17-21, 25, 86-7, 152, 232).

15. Mr. E. Parsons did not sign the written contract dated March 2 since he did not want to be bound to a contract requiring the performance of stripping which would take a long time,[3] since, if an opportunity opened up, he wanted to go back to road building work.[4]

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[2] P-2 is admissible as evidence of the terms of the oral 1942 agreement, even though the language of P-2 was rejected by the parties (N. T. 19-20).

[3] During the trial, the witnesses referred to the 1942 written agreement (P-2) as a long-term contract, apparently because the stripping required by it would take a long time.

[4] See testimony of Mr. George to this effect (N. T. 152). Mr. Wetter testified that he saw Mr. E. Parsons on the mining property sometimes in 1942 and would then discuss the work with him. His testimony substantiated that of Mr. George as to the statements of E. Parsons concerning the reason why he did not want a written agreement. Also, Mr. Wetter testified that, at the meeting in Mr. George's office with E. Parsons in August 1943, Mr. Parsons reiterated those statements (N. T. 180, 183). Plaintiff E. Parsons, contrariwise, testified that he did not sign P-2 because the agreement had a definite amount to be stripped in the area enclosed in the red lines on the attached map and if he signed, he would have been tied to strip the entire area, all of which had already been mined. He testified that when, at the time of the February 27 meeting in Rockhill's office, he looked at the map on the wall, he had not known that Rockhill was going to include the old workings in that area but that, while the agreement was being written, he looked over the area (something he had not done at the time of the February 27 meeting—N. T. 18) and found that half of it had previously been deep mined and the shaft into it was lying on such a steep pitch that he did not know whether he could strip it or not (N. T. 21, 95, 96, 98, 115). Though the Kelly seam, the Speer seam, and part of the Barnett seam had solid coal (N. T. 96-7), plaintiff

[fol. 14] 16. Parsons instead proposed that they would operate the property for Rockhill on the area that was assigned to them if there was no written contract but a terminable arrangement on terms similar to the 1941 written agreement (N. T. 152).[5] George and Morgan stated that they could not accept Parsons' proposal until they took it up with Mr. William Wetter, President of Rockhill, who was in Philadelphia (N. T. 14, 22, 26, 115, 152).

17. A week or two later George told Parsons that Rockhill would agree to such a verbal agreement[6] under which, if Parsons or Rockhill wanted to quit, all that was necessary to terminate the arrangement was the giving of a

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E. W. Parsons testified that he did not make, ask for, or want a written agreement with Rockhill for those areas or any of the other areas they stripped on Rockhill property (N. T. 82, 98-9). He also testified that he signed the 1941 agreement (P-1) because the area had previously been drilled by the coal company in the center of the property and it was a solid piece of coal (N. T. 101). Thus, plaintiff E. W. Parsons' testimony that, unless Parsons had previously prospected or drilled the area so that they could determine how much coal they could strip on the specific area, they would not sign a written agreement (N. T. 99, 100), does not seem capable of reconciliation with the fact that when they did discover that they had a solid piece of coal on certain of the Rockhill areas they stripped, they still did not want a written agreement (N. T. 102). In addition, the testimony of Mr. Wetter seemed most persuasive to the trial judge.

[5] Plaintiff E. Parsons, though, testified that the coal stripping was done under an oral modification of the 1941 written contract (N. T. 77, 82-3). But, though most of the bi-weekly statements sent to Parsons from Rockhill for the period following the winter of 1942, showing the amounts of coal loaded during the preceding two weeks (P-5) specified February 17, 1941, as the contract date (some of these statements have no date and others use the date February 17, 1942--see D-15), such notations are inconsistent with the evidence in the record (see Exhibits D-14 and D-15).

[6] It was Rockhill's intention to get a written contract if they could. They were willing to accept the oral arrangement suggested by Mr. Parsons in place of the written agreement that Parsons refused to sign because they needed coal very badly at that time. They were losing their men in the deep coal mines they operated and had to increase their tonnage through stripping operations (N. T. 206).

ten-day notice. Parsons agreed to this arrangement (N. T. 152, 153, 185).[7]

[fol. 15] 18. If Rockhill had cancelled on ten-day notice and Parsons had previously gone to the expense of removing the overburden (thereby performing the heavy part of the work, as well as meeting wages and expenses in so doing), then Parsons would have had the privilege of taking out the coal under the above-mentioned removed overburden and of being paid for it, apparently even though this took more than ten days (N. T. 184, 185). Plaintiffs were not bound to remain until the prospected coal was exhausted. They had the right, however, to stay and take out from the coal they found as much coal as they economically could take out at a profit with their equipment (N. T. 119-122).[8]

19. The amount of equipment or the number of workers that Parsons could have used on the allocated areas was in the discretion of Parsons (N. T. 213, 242, 249). Similarly, the quantity of coal stripped was in the discretion of Parsons subject to the following two sentences (N. T. 213-4). But if Parsons stripped coal at such a rate that Rockhill could not get enough of their deep mined coal to

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[7] Mr. Parsons testified to the contrary that his counter-proposal to his refusal to sign the March 2 written contract was that he would go on the area, prospect it, and strip it under the same terms as their 1941 agreement. He proposed to go any place on their property and prospect such area, provided that, if he found any coal, he would have the right to take the entire piece out (N. T. 21, 23, 26, 82, 83, 98, 99, 115, 118, 119). He specified that Mr. George accepted this proposal after getting permission to do so from Mr. Wetter and told him a week or two after March 2 that it was satisfactory for him to go ahead and prospect the area on those terms (N. T. 22, 29, 116). He testified that nothing was said about the right of either party to terminate the agreement (N. T. 22-3). E. Parsons also testified that he believed that Rockhill did not have the same right to terminate the arrangement that Parsons enjoyed. He claimed that only if there was no longer any coal prospected could Rockhill have terminated on 30 days' notice (N. T. 119), while when Parsons did finally cancel in 1950, giving 30 days' notice, they were not violating the agreement (N. T. 118).

[8] When Parsons quit the job site in 1950, there was never any discussion of damages (N. T. 208).

blend with the stripped coal, then Rockhill did not have to accept the coal that Parsons stripped, but would have had to terminate the oral arrangement under the ten-day clause (N. T. 171, 210, 213-4 and paragraph 18 of the 1941 written contract). In this manner, Rockhill controlled the quality and quantity of coal that Parsons stripped (N. T. 214, 221).

20. Rockhill reserved the right to hire other strippers to strip in areas not allocated to Parsons (N. T. 210-1).[9] On ten days' notice, Rockhill could have put another stripper on any area that had been allocated previously to Parsons (N. T. 211).

[fol. 16] 21. Rockhill, and not Parsons, had the right to sell all the coal (N. T. 212, 220).[10] Parsons never sold any coal that it mined from Rockhill property (N. T. 115). Parsons did not have the right to receive payment in coal rather than in money (N. T. 221). If the coal was not blendable, the record indicates that it was not feasible for Parsons to sell it to anyone else[11] (see Finding of Fact No. 28 below).

22. Parsons was paid a stated amount[12] of money per ton of coal delivered to Rockhill's railroad cars (N. T. 35-

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[9] In 1950, Rockhill employed another contractor on another section of their property (N. T. 103).

[10] Parsons was not given legal title to the Rockhill properties (N. T. 211).

[11] The record indicates that it was necessary to use the railroad owned by Rockhill in order to transport the coal to market (N. T. 23, 46-8, 124, 153; cf. 35-6). This indication that Rockhill was the only feasible purchaser of any coal secured from this area due to its ownership of the railroad is confirmed by (1) the testimony that Miller & Corrie sold coal to Rockhill, which coal was loaded on the latter's railroad (N. T. 49), and (2) the testimony that Parsons left the coal rejected by Rockhill in the pits at the termination of its coal stripping for Rockhill (N. T. 38, 48). (See Findings of Fact Nos. 28 and 35.)

[12] The price per ton paid to Parsons was a fixed amount and was not to vary if the market price went up or down. There was no provision in any of the contracts for increases or decreases in such price in relation to the market prices (N. T. 108), but in setting

6).[13] According to the oral contract,[14] changes in the stated price per ton were to reflect only increases in wage or labor costs (N. T. 36, 108), but after the increases began to take effect in materials and explosives, Rockhill went along with Parsons and granted increases for such reasons (N. T. 37, [fol. 17] 87, 212).[15] These additional increases were in the nature of new oral agreements.[16]

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the price, Parsons took into consideration that such price would include their profit (N. T. 88). Rockhill assumed the risk of a change in the market price (N. T. 211-2), but see footnote 16 below.

[13] The contracts under which Parsons operated were salvage contracts, as distinguished from yardage contracts. In a salvage contract there are no separate payments for the removal of overburden as there are in a yardage contract. The stripper takes the risk, but the price reflects that risk. In a salvage operation, the price paid per unit of coal is predicated upon the total cost of doing the job (N. T. 195-6). If a stripper found no coal, he would not get paid for expenses in removing such overburden, but such a result was not likely to have occurred on the Rockhill lands, known to have coal deposits therein (N. T. 196-7).

[14] The unsigned March 1942 agreement, which was offered to Parsons, provided for a fixed price per ton of merchantable coal which the stripping contractor was to be paid (N. T. 86, 101).

[15] From 1942 to 1950, on those areas not covered by the 1941 written contract, price increases were handled in the same way as under the terms of the 1941 contract—namely, E. Parsons met with George and Morgan and they together figured out the increase on a tonnage or percentage basis (N. T. 36-7, 117, 124). Though the 1941 agreement provided only for increases due to labor increases, Parsons also negotiated and received increases in price for increases in the cost of materials (N. T. 117-8), except that for increases due to the latter factor, Parsons alone figured it out and then asked Rockhill for an increase in price (N. T. 125).

[16] Under the 1941 written agreement, a price increase was given on August 15, 1941, to $1.65 per ton (N. T. 155), and the price fixed in the new oral contract was, similarly, $1.65 per ton of coal delivered at Rockhill's tipple in the railroad car (N. T. 153). On February 1, 1943, the price was increased to $1.78 because of wage increases (N. T. 156). On August 12, 1943, the price was increased to $2.00 after E. Parsons told Wetter and George that Parsons was going to quit and take their equipment off Rockhill property in about three months when they took out an estimated 15,000 more tons from the Fire Tower tract and the Thomas tract (Area No. 2),

[fol. 18] 23. The price per ton of coal delivered paid to Parsons covered all the work incidental thereto. It included all of Parsons' expenses in prospecting and mining the coal, the cost of roads they had to build, depreciation on their equipment, the cost of their supplies, the cost of their labor,

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since they could lease on a rental basis their equipment at a greater price than they were getting for removing coal ($5,000. monthly profit renting as against their present $780. monthly profit) or they would get a higher price per ton ($2.25) for stripping in the Clearfield County area. Rockhill agreed to the price increase, which was not based on an increase in labor costs or on material costs, if Parsons would build a road and open a 30-acre tract due north of the Thomas tract (N. T. 160-2).

E. Parsons testified, though, that all of the increases given to Parsons by Rockhill were based on those two latter reasons, and that plaintiffs never asked for an increase because other strippers were being paid more per ton than plaintiffs were getting, though they may have made such a representation in conversations with Rockhill's representatives (N. T. 111-5).

Since Mr. George, who testified contrary to the testimony of E. Parsons, testified upon his present recollection as refreshed by notes which were made in 1954 from a statement answering an inquiry from the Federal Government and Tax Division, when George first knew he was to be a witness in this case, and such statement was made from papers in his file that were made at or about the time of the events (N. T. 154, 158-9, 214-6, 22), his testimony will be accepted as more accurate. Later, the defendant offered the original notes and memoranda made contemporaneously with the meetings with Mr. Parsons, at various times from 1940 to 1950, in evidence (N. T. 22, 225-31, Exhibits D-16 through D-30).

On July 1, 1944, the price was reduced to $1.98 because Rockhill assumed the responsibility of slate picking at the tipple and in the pit (N. T. 162-3). On November 1, 1944, the price was increased to $2.23 due to increased costs for drilling equipment and explosives necessitated because of high overburden (N. T. 165 and Exhibit D-22). On August 9, 1945, the price on the Fulton and Barnett seams was increased 5¢ per ton to $2.28 and the price on the Kelley seam was increased 25¢ per ton to $2.48 (N. T. 164-5 and Exhibit D-23). These increases averaged out to $2.38 per ton for all the three seams. For the period between May 1, 1945, and July 1, 1945, a retroactive increase of 15¢ per ton was given by Rockhill (N. T. 166). On July 1, 1946, the price was increased 10¢ to $2.48 per ton due to increased labor costs. On September 1, 1946, the price was again increased 10¢ to $2.58 per ton (N. T. 167-8). On November 14, 1956, the price was increased 30¢ to $2.88 per ton due to material changes and was then reduced 25¢ to $2.63 per ton due to Parsons' starting to operate Rockhill's 621-S Page Dragline

the cost of dockage, the cost of creating a tipple and the cost of picking or cleaning the coal (until the latter was taken over by Rockhill and such cost was deducted from the payment per ton given to Parsons) (N. T. 87-8, 154, 179, 238).[17]

24. In all the areas where Parsons worked on Rockhill property, Rockhill made the necessary deposit under the Bituminous Coal Open Pit Mining Conservation Act, as amended, 52 P. S. 1396.1-1396.20, for restoration and replanting of the property after the stripping operation was completed, as required by the Act (N. T. 193-4, 221).[18]

25. The areas in which Parsons was to work were allocated by Rockhill's Engineering Department, which pre- [fol. 19] liminarily surveyed the area on which Parsons was

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(N. T. 168 and Exhibit D-24). On July 15, 1947, the price was increased 25¢ to $2.88 per ton due to increased labor costs (N. T. 169 and Exhibit D-25). In 1948, the price was increased 20¢ to $3.08 per ton due to the cost of explosives necessitated by heavy overburden (N. T. 169 and Exhibit D-26). On June 1, 1949, the price was reduced 20¢ to $2.88 per ton due to Parsons' starting to use a second (the 625) dragline of Rockhill (N. T. 169 and Exhibit D-27).

[17] Exclusive of the Fire Tower tract, during the years 1942 through 1950, for work on the areas under the new oral contract, Parsons paid the expenses of the stripping operation which included: labor compensation, social security, unemployment compensation, repair parts, fuels, truck hire, equipment, rental, and explosives (N. T. 35). From 1942 on, Parsons had to build or resurface approximately six miles of road in connection with their entire stripping on Rockhill property (N. T. 24, 35). Also, in 1945 Parsons cleared the right of way and graded it so a railroad going up to Area No. 7 could be put down (N. T. 47-8). But some roads were put in before Parsons went into those areas (N. T. 110). From 1943 to the present, Parsons never built any roads other than roads in connection with stripping operations (N. T. 50).

[18] 52 P. S. § 1396.4 requires any operator (a person engaged in open pit mining and "who is or becomes the owner of such coal as a result of such mining"—see 52 P. S. § 1396.3) to file "a bond . . . conditioned that the operator shall faithfully perform all of the requirements of this act." The operator may deposit cash, United States Government bonds, Commonwealth of Pennsylvania bonds, Pennsylvania Turnpike bonds, or similar bonds, in connection with the above-described bond (see N. T. 193-4).

to operate (N. T. 170, 221).[19] All of the Rockhill property previously had been completely drilled and tested and some of it had been previously deep mined (N. T. 170, 176).[20] E. Parsons always was with Rockhill's engineer or inspector when any sites were taken into consideration (N. T. 247) and, similarly, Rockhill's engineer or inspector went along with Parsons when Parsons prospected for coal (N. T. 31, 37).[21]

26. When Parsons began stripping under the oral contract in March of 1942, they were still stripping the Fire Tower area covered by the 1941 written contract (N. T. 23-4).

27. Under the oral contracts, with the changes noted in footnote 16, Parsons stripped coal from March 1942 to September 1, 1950, on four different seams on the Broad Top region known as Fulton, Barnett, Kelley, and Speer (N. T. 7, 8, 204). Included therein were nine areas (N. T. 24, 29, 59, and Exhibit P-3). Area No. 1 was the Fire Tower tract (N. T. 29 and Findings of Fact Nos. 11 and 26). Area No. 2 was the area discussed at the meeting of [fol. 20] February 27, 1942 (N. T. 95 and see Finding of

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[19] In addition to designating the areas for stripping, Rockhill had control over where Parsons placed the waste material from the coal stripping operations (N. T. 171).

[20] The bore hole records provided by Rockhill were mostly exact, but unsuccessful prospecting in at least 100 places between 1942 and 1950 resulted from areas where there had been extended mining and areas where there were no bore hole records on the outcrop coal (N. T. 31, 239). Generally, the prospecting done by Parsons was 60% successful (N. T. 238). There was testimony that during these unsuccessful prospecting attempts, Parsons made use of Rockhill's bore hole records only once because such holes were drilled for mining purposes and carried a heavy cover (N. T. 32), but also there was testimony that Rockhill had an idea where coal could be found (N. T. 170). When the Miller Contracting Company took over the stripping operations after Parsons left in 1950, more often than not their prospecting was unsuccessful (N. T. 141-2).

[21] An inspector was on the job at all times. His duty was to see that the coal was properly cleaned before it was loaded. Rockhill did not assist Parsons in their stripping operations, but at one point they took over the picking (cleaning) operations (N. T. 221 and see Finding of Fact No. 24).

Fact No. 13 above). Following the making of the oral contract Parsons spent about one year stripping a portion of Area No. 2 and did get merchantable coal from it (N. T. 96, 98). When Parsons finished stripping Area No. 2, Rockhill took them to Area No. 3[22] and they prospected, found and stripped the salable coal there (N. T. 37, 47).

28. Area No. 9 was the last area Parsons stripped under their arrangement with Rockhill (N. T. 29, 30).[23] When Parsons ceased stripping for Rockhill, no coal was left uncovered on Area No. 9 (N. T. 38) and Parsons was not stripping profitably, as much of the coal was rejected and left in the pits (N. T. 38). But Parsons had not prospected, so that they did not know whether there was any coal usable by Rockhill left in the areas they were working (N. T. 103).

29. The Miller Contracting Company moved onto Rockhill property in 1949, and in September 1950 continued the stripping of Area No. 9 where Parsons left off (N. T. 49,

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[22] Under the oral contract, the General Manager of Rockhill had the right to designate the sites Parsons would strip (N. T. 212, 220). If the unsigned agreement of March 1942 had been executed each time the stripper moved to another area not covered by such an executed agreement, Rockhill would have made a supplemental agreement that would have covered such additional area (N. T. 187). Such contracts might be a master contract covering large areas or a contract covering a limited area and a succession of smaller supplements, each covering a specific area (N. T. 189). Evidence of a practice on behalf of Rockhill to make written contracts in its stripping arrangements is that Rockhill had two written contracts with Miller Contracting Company, which were supplemented with one contract combining them (N. T. 187). Mr. Wetter, President of Rockhill, testified that as a coal company executive, it was his practice, with the five or six strippers that he had dealt with and with the Miller Contracting Company, always to have a written agreement. Only with Parsons did he ever operate under an oral contract (N. T. 190-1).

[23] There is no evidence on exactly what part of Rockhill's land Parsons was strip mining during the years 1945 through 1949, except that Parsons was strip mining Area No. 9 when it quit. From the areas numbered 2 through 9, Parsons took out 15 pieces of coal (N. T. 30). From 1944 on, Parsons was stripping more than one piece at a time (N. T. 32, 35).

103, 136-7). The Miller Company stripped that area on three [fol. 21] separate occasions over a period of five years.[24] Initially, on taking over where Parsons left off, they did not get good, strippable coal but they then shifted the direction of their stripping operations and ran into good coal. From Area No. 9, the Miller Contracting Company got some of the best coal they ever got on Rockhill property (N. T. 138-147).

30. Parsons did not consider themselves bound to mine the Rockhill properties to exhaustion (N. T. 94). When they stopped operating on Rockhill property in 1950, strippable coal remained on the property (N. T. 204-6). Strip mining of Rockhill property was continued by the Miller Contracting Company until March 31, 1956 (N. T. 205), but 7 or 8 million tons of strippable coal that can be profitably removed still remained on the property when Rockhill sold such property on May 1, 1956 (N. T. 206, 248-9).

31. Rockhill started putting in its own equipment on the areas Parsons was working in 1946 (N. T. 103, 172).[25] During the years 1945 through 1949, Parsons removed some of its own equipment from the Rockhill property (N. T. 104).[26] In 1943 the value of the equipment that Parsons

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[24] The first time they stripped in the area, they took out coal from a five to six acre area, the second time from an area of about three acres, and the last time from an area of about five acres (N. T. 143-5).

[25] This equipment included a 621-S Page Walking Dragline valued at approximately $140,000. and a 625 Page Walking Dragline put on in 1948 valued at approximately $225,000. (N. T. 103-4, 171-2, Exhibit D-12). For the equipment Rockhill put on the job, Parsons paid a tonnage rental of 25¢ (N. T. 123).

[26] In July 1949, they sold a Northwest dragline and Bucyrus Monagan dragline, each valued at approximately $25,000., and a D-8 Caterpillar bulldozer valued at approximately $10,000. to the corporation plaintiff Lawrence Parsons worked for after leaving Parsons (N. T. 105-6, 132-3, 170). In 1945 and 1946, Rockhill sold a dragline that was never on Rockhill's property and a bulldozer (the bulldozer was taken from Rockhill's property) to Parsons Contracting Company (N. T. 106-7, 131). Parsons got Rockhill's consent to selling the equipment in 1948 and 1949, but for the one bulldozer sold to Parsons Contracting Company Parsons did not get Rockhill's consent since they considered it a small, old piece of equipment (N. T. 107-8).

[fol. 22] had on the Rockhill job was approximately $60,000. (N. T. 125-6).[27] In 1946, the total value of the equipment Parsons had on the job had increased to approximately $210,000. (N. T. 128).[28] In that year, Rockhill's own equipment being used by Parsons had a value of approximately $130,000. (N. T. 209). In 1949, Rockhill added to the equipment being used by Parsons for the coal stripping operation an additional dragline valued at $240,000. (N. T. 210), while Parsons' total equipment valuation on the job in 1949 was around $200,000. (N. T. 210).[29] When Parsons ceased stripping on Rockhill property on September 1, 1950, they had only $125,000. worth of equipment on Rockhill property (N. T. 133).[30]

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[27] The major pieces of equipment that Parsons had on the Rockhill job in 1943 were three tractors and scrapers, a loading shovel (20-B Bucyrus-Erie), and a 79 Lorrain high lift shovel. Also, they had a lot of small equipment, such as compressors, pumps and drills. Parsons paid $11,000. for each tractor and scraper, $10,000. for the loading shovel, and approximately $15,000. for the high lift shovel (N. T. 125-6).

[28] In 1944 Parsons bought three Euclid trucks costing about $40,000., increasing their total equipment valuation on the job in 1944 to approximately $100,000. (N. T. 127-8). In 1945, Parsons bought two draglines and two loading shovels, increasing their total equipment valuation on the job (exclusive of the equipment being used by the Miller and Corrie job—see Finding of Fact No. 35) in 1945 to approximately $180,000. (N. T. 127-8, 130-2). In 1946 Parsons bought a dragline and traded one of their draglines for a larger dragline, increasing their total equipment valuation on the job in 1946 to approximately $210,000. (N. T. 128).

[29] In 1947, Parsons bought three Euclid trucks, a bulldozer and a shovel, bringing the total value of equipment Parsons had on the job in 1947 to approximately $250,000. (N. T. 128). Parsons did not buy any equipment in 1948 but sold two scrapers and tractors for $10,000. and a dragline for $25,000., so that the total value of the equipment Parsons had on the job in 1948 was approximately $215,000. (N. T. 129-130). In 1949, Parsons maintained the same equipment on the job (N. T. 130), except for selling one dragline for $25,000. to the corporation plaintiff Lawrence Parsons formed on leaving Parsons (N. T. 133, and see Exhibit D-28).

[30] In view of the reasoning outlined in footnote 18 of opinion 3/26/57 in *Huss et al. v. Smith, Collector*, Civil Action Nos. 14,775-7

32. Under the 1941 written contract, Parsons had the privilege of removing any and all of its equipment in any [fol. 23] calendar year for the period from April 1 to September 1,[31] and Rockhill was not required to take any coal during that period.[32] Stripping under the 1941 written contract was suspended once when, as per the agreement, Rockhill only took coal from September 1 until April 1 and Parsons went out and did roadbuilding (N. T. 16, 118, and see Exhibit D-18), but Parsons never ceased their stripping operations during the summer months from 1942 to 1950 (N. T. 238).

33. In 1946, plaintiffs Lawrence H. and Howard H. Parsons formed an additional partnership, Parsons Contracting Company, which company strip mined the Kunkle tract and ceased operations in 1947 (N. T. 57-8, 85, 88). Parsons rented them equipment and took depletion on such tract for the royalties that were paid to them (N. T. 85-6, and see Exhibit D-28).

34. In 1943, Parsons moved onto and began strip mining Ednie Coal Company property at Broad Top City, about three miles from Rockhill property. The property did not turn out as well as Parsons believed it would and, with George's permission, they moved back into Rockhill property two days later (N. T. 202-4). There was no ob-

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(E. D. Pa.), the value of the equipment used by Parsons (which was subject to the deduction for depreciation) would seem to be irrelevant,—particularly in view of the substantial investment in such equipment by Rockhill.

[31] See paragraph 14 of the 1941 written contract, which was included at Parsons' request since they were road builders and thought they might do some roadwork in the summertime when the work was not steady. There was no understanding or discussion of that kind under the March 1942 oral contract (N. T. 175-6).

[32] By giving at least ten days' notice prior to April 1 of any calendar year, paragraph 14 of the unsigned March 1942 contract (P-2) permitted Rockhill to refuse to take coal under that contract during the period from April 1 to September 1. But in that contract no privilege was given to Parsons to remove any or all of its equipment (N. T. 233-8).

jection raised by Rockhill to Parsons' prospecting on Ednie property (N. T. 245).[33]

[fol. 24] 35. In 1945 and the early part of 1946, Parsons, in addition to stripping on Rockhill property, also stripped on George Miller property under a contract with Miller and Corrie. The coal Parsons stripped was bought by Rockhill from Miller and Corrie and loaded directly by Parsons on Rockhill's railroad (N. T. 49, 85).[34]

36. On August 1, 1950, plaintiff E. Parsons gave George (Rockhill's representative) thirty days' notice[35] of Parsons' ceasing operations (N. T. 38-9, 205, and Exhibit D-30). During the following thirty days, Parsons continued to strip mine[36] coal that had been cleared of overburden (N. T. 206) and continued operations until September 5, loading the coal they had stripped (N. T. 208).

37. After leaving their operations with Rockhill, Parsons began stripping as sub-lessee for the New York & Pennsylvania Company, Inc. (sub-lessor) in September 1950 under a lease agreement entered into on July 20, 1950, while still stripping for Rockhill (N. T. 59-60 and Exhibit D-31).

38. Depletion was never mentioned by either of the parties to the oral, March 1942 agreement (N. T. 88, 154, 179).[37] Under Parsons' new contract with the New York

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[33] George, Wetter and Morgan were officers and/or Directors of the Ednie Coal Company, and George and Wetter were stockholders of both Rockhill and Ednie (N. T. 242-5).

[34] 25% of plaintiffs' 1945 expenses and 5% of plaintiffs' 1946 expenses were attributable to the Miller and Corrie job (N. T. 50).

[35] Plaintiff E. Parsons offered a longer notice to Rockhill if thirty days was insufficient, but George said thirty days was all right (N. T. 38-9).

[36] When Parsons told Rockhill that they were quitting, Rockhill took over the operation of their 625 dragline that Parsons had been operating. To keep the job operating, Rockhill also purchased and put on the job the equipment that Parsons had sold to a dealer (N. T. 174).

[37] During the period Parsons was working for Rockhill, its representatives never requested their attorney to make a written agree-

[fol. 25] & Pennsylvania Company, Inc., Parsons receives percentage depletion (N. T. 60).[38] The Miller Company's stripping contract with Rockhill, signed in 1950, provides that the Miller Company has no economic interest in the coal (N. T. 142).

39. In the taxable years here under consideration, Rockhill took the depletion deduction on the operations performed by Parsons on Rockhill property (N. T. 178-9), and Parsons did not take such depletion on their partnership income tax returns (N. T. 89),[39] though, during those same years, Parsons' income tax returns did take depletion deductions on property other than Rockhill's (N. T. 92-4).

Paragraphs 9, 13, 14, 15, 43 and 46 requested by plaintiffs and paragraphs 17 to 25 requested by defendant are

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ment under the terms of which they would have been assured a depletion allowance (N. T. 103). Rockhill never told Parsons that they would get the depletion on their operations on Rockhill property (N. T. 179).

[38] There are many substantial differences in Parsons' 1950 arrangement with the New York & Pennsylvania Co., Inc. and Parsons' earlier arrangements with Rockhill which would tend to give Parsons a depletable interest from the former operation, though not in the latter. Examples of such differences between the two agreements are to be found in the following conditions of Parsons' 1950 agreement with the New York & Pennsylvania Co., Inc.: if the annual tonnage requirements fell below 150,000 tons per year or increased above 250,000 tons per year, the parties agreed to renegotiate the price (par. 5 of D-31); upon written permission and the payment of royalties to be agreed upon, Parsons was permitted to sell rejected coal to third parties (par. 6 of D-31); Parsons agreed to comply with the requirements of the Bituminous Coal Open Pit Mining Conservation Act of Pennsylvania (par. 8 of D-31); the agreement could not be terminated by Parsons for three years from the date operations commenced on the premises and then only on six months' notice in writing (par. 15 of D-31) (but the New York & Pennsylvania Co., Inc. could have terminated upon ten days' written notice if Parsons failed to pay the royalty or failed to furnish and deliver coal—par. 10 of D-31); and, finally, the 1950 agreement is in writing in the form of a lease (par. 1 of D-31).

[39] During these years, Mr. Austin W. Rice, a certified public accountant, made out the annual partnership income tax returns (N. T. 62-3).

correct, but are found by the court to be of slight or no relevancy.

All plaintiffs' and defendant's Requests for Findings of Fact which are inconsistent with the foregoing are denied.

[fol. 26] DISCUSSION

See Section II, "Discussion," in *Huss et al. v. Francis R. Smith, Collector,* Civil Actions Nos. 14,775, 14,776 and 14,777 (E. D. Pa.), pages 14 to 24 of opinion filed on March 26, 1957 which outlines the law as enunciated by the various cases and is adhered to in this case. See, in particular, *Commissioner of Internal Revenue v. Mammoth Coal Co.,* 229 F.2d 535 (3rd Cir. 1955), rehearing denied 229 F.2d 539 (3rd Cir. 1956), cert. den. 352 U.S. 824 (1956).

Plaintiffs are not entitled to percentage depletion on amounts received under the oral contracts with Rockhill based on these principles:

A. *The Right of Plaintiffs to Strip Mine Was Terminable On Ten Days' Notice at the Will of the Owner of the Coal Lands.*

Only if Parsons had gone to the expense of removing the overburden, performing the heavy part of the work, meeting wages and expenses in so doing, would they have had the exclusive right to take out the coal under such overburden and to be paid the stated price per ton for it. Otherwise, Rockhill could have terminated the arrangement by giving a ten-day notice, or Rockhill, by the same ten-day notice, could have put another stripper on any area that had been allocated previously to Parsons (see Findings of Fact Nos. 17-19, 21 and 30).

Plaintiffs have failed to sustain their burden in proving the terms of the oral contracts as testified to by E. Parsons (see Findings of Fact Nos. 15 through 19 and footnotes 4, 5 and 7).

B. *Plaintiffs Had a Right to Receive a Fixed Price Per Ton, Irrespective of the Market Price.*

The situation presented by these oral contracts is one where Rockhill had the right to sell all the coal. Plaintiffs

[fol. 27] were always paid by Rockhill a stated price per ton for the strip mined coal delivered to Rockhill's railroad car (see Findings of Fact Nos. 22 and 23). Such price was adjustable to reflect increases in wage or labor costs and increases in materials or explosives, but not any changes in the market price (see Finding of Fact No. 23, and footnotes 9 and 16).

If Rockhill rejected the coal as not capable of being blended with their deep mined coal, there is no indication in the record that it was feasible for Parsons to sell to anyone else.[40] Thereafter, Parsons or Rockhill would presumably

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[40] Plaintiffs cite this sentence of paragraph 1 of P-1 as giving them the right to sell rejected coal to buyers other than Rockhill:

> "Contractor shall, at its own cost and expense, strip, remove and dispose of all overburden including rock, refuse, gob and black dirt, etc., and any coal which in the opinion of the General Manager of Coal Company may be unmarketable; . . ."

Plaintiffs point out that the testimony indicated that all the terms of P-1 (except the provisions concerning terminability) were incorporated in the oral 1942 agreement in relying on the above-quoted sentence to establish their right to sell the rejected coal. Mr. George testified that Rockhill had the right to sell "all the coal" and Parsons "had no right at all" to make such sales (N. T. 212), indicating that Parsons had no right to sell even coal rejected by Rockhill to any other buyer. In any event, the trial judge does not believe that such general testimony concerning the contents of P-1 being the same as the contents of the 1942 oral agreement and the very general language contained in the above-quoted sentence sustain plaintiffs' burden to show that it was possible for Parsons to sell the rejected coal to anyone, in view of the following items of evidence in the record:

1. The testimony concerning Parsons' duty to dispose of overburden (under the supervision of Rockhill's inspector) indicates that the reference to the coal in this sentence only refers to that type of coal which was completely unmarketable and in the nature of dirt and debris (N. T. 171, 194, 7).

2. Mr. George testified that plaintiffs did not have the right to accept coal instead of money (N. T. 221).

3. Plaintiffs never in fact sold any coal to anyone other than Rockhill (Finding of Fact 21).

4. The testimony indicates that it was not feasible for plaintiffs to sell rejected coal to anyone, even if they had such a right (see Findings of Fact 21 and 28).

Under these circumstances, plaintiffs have failed to sustain the burden of showing that any such sales to buyers other than Rockhill were feasible.

terminate the arrangement by giving the requisite termination notice. The testimony indicates that Parsons never did sell the coal to anyone other than Rockhill and coal that was [fol. 28] rejected by Rockhill was left in the pits (see Findings of Fact Nos. 20, 21, 22 and 28).[41]

C. *The Coal Remained an Asset of Rockhill, Rather Than of Plaintiffs.*

It is apparent that plaintiffs have not shown that they looked to the severance and sale of the coal on the open market for their compensation.[42] Instead, plaintiffs' compensation was directly dependent upon their personal covenants with Rockhill. This latter does not entitle plaintiffs to a depletion allowance and, therefore, they are not entitled to share in the benefits of a statute which was designed to give compensation to persons having an economic interest in the depletion of a wasting asset.[43]

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[41] This testimony distinguishes this arrangement from the oral Stevens contracts in *Huss et al. v. Francis R. Smith, Collector*, supra, where Huss had the power to, and could feasibly, sell the coal to anyone they wished, notwithstanding that Stevens rejected the coal.

[42] There is no evidence in the record that shows any definite tonnage production obligation by plaintiffs (see Finding of Fact No. 19). Also, it is noted that plaintiffs did not take the depletion deduction on their operations on Rockhill property on their partnership income tax returns, though they did take such a deduction on property other than that of Rockhill (see Findings of Fact Nos. 38 and 39).

[43] In addition to the cases cited in *Huss et al. v. Francis R. Smith, Collector*, supra, which state this principle of law, more recently the United States Court of Appeals for the Third Circuit has held in *Turkey Run Fuels, Inc. v. United States*, No. 11,973 (3rd Cir. 1957), that a taxpayer-mine owner was entitled to the depletion deduction from royalties received for coal extracted by a stripper from coal, culm and refuse banks which had been created many years before in mining operations by lessees of the taxpayer's predecessors in title to the land.

The court reasoned that since "the taxpayer is the owner of the coal, culm and refuse banks in question, of the land upon which they lie and of the coal mines from which they were extracted," such taxpayer "therefore has the economic interest therein which the Internal Revenue Code requires and which (the stripper)

These factors give the plaintiffs an economic advantage, rather than an economic interest, in the coal in place, and do not entitle them to a percentage depletion deduction.

[fol. 29] CONCLUSIONS OF LAW

1. This court has jurisdiction over the parties and the subject matter.

2. 33 P. S. § 1 has no application to these oral contracts.[44]

3. 28 U. S. C. A. § 2514 has no application to this case.[45]

4. Defendant's motion at the close of the plaintiffs' evidence for dismissal of plaintiffs' case[46] under Rule 41 of the Federal Rules of Civil Procedure, and plaintiffs' and defendant's motions at the end of all the evidence for a directed verdict[47] under Rule 50, are moot in view of paragraph 5 of these Conclusions of Law.

5. Plaintiffs, in strip mining under oral contracts with the Rockhill Coal Company in the tax years 1945 to 1949, inclusive, did not acquire an economic interest in the coal in place, entitling them to the depletion allowance on their gross income derived therefrom, pursuant to §§ 23(m) and 114(b) of the Internal Revenue Code of 1939.

6. Defendant Francis R. Smith, Former Collector of Internal Revenue for the First District of Pennsylvania, is entitled to the entry of judgment in his favor with costs.

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as lessee did not have." Therefore, "the royalties received by the taxpayer for the coal extracted from the banks . . . constituted income from mining from which the depletion allowance was deductible."

[44] See footnote 24 in *Huss et al. v. Francis R. Smith, Collector*, supra.

[45] In view of Conclusion of Law No. 5 below, it is not necessary to consider whether 28 U. S. C. A. § 2514 only applies to cases in the Court of Claims (see *Corkle v. United States*, 94 F. Supp. 908 (E. D. S. C. 1951)) and, therefore, would have no application to this proceeding.

[46] N. T. 148-9.

[47] N. T. 252.

[fol. 30]

IN UNITED STATES DISTRICT COURT

JUDGMENT ORDER—May 28, 1957

And Now, May 28, 1957, It Is Ordered that judgment be entered in favor of Francis R. Smith, Former Collector of Internal Revenue for the First District of Pennsylvania, and against Emory W. Parsons, Erma M. Parsons, Howard H. Parsons, Martha Parsons, Lawrence H. Parsons and Grace E. Parsons, with prejudice, and with costs.

/s/ Francis L. Van Dusen, J.

[fol. 30a] [File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

C.A. No. 15229

EMORY W. PARSONS and ERMA M. PARSONS,

vs.

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

NOTICE OF APPEAL—Filed June 14, 1957

To the Clerk, United States Court of Appeals, Third Circuit, Philadelphia, Penna.

Please be advised that the plaintiffs in the above entitled case has this day filed Notice of Appeal to the United States Court of Appeals, Third Circuit, Philadelphia, Pennsylvania, from a Judgment or Decree of this Court by Honorable Francis L. Van Dusen.

Gilbert W. Ludwig, Clerk.

For Appellant: William R. Spofford, Esq., Charles S. Jacobs, Esq., Sherwin T. McDowell, Esq., Charles I. Thompson, Esq.

For Appellee: Harold K. Wood, Esq., U. S. Attorney.

[fol. 30b] [File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

C.A. No. 15230

HOWARD H. PARSONS and MARTHA PARSONS,

vs

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

NOTICE OF APPEAL—Filed June 14, 1957

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Gilbert W. Ludwig, Clerk.

For Appellant: William R. Spofford, Esq., Charles S. Jacobs, Esq., Sherwin T. McDowell, Esq., Charles I. Thompson, Esq.

For Appellee: Harold K. Wood, Esq., U. S. Attorney.

[fol. 30c] [File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

C.A. No. 15231

LAWRENCE H. PARSONS and GRACE E. PARSONS,

vs

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

NOTICE OF APPEAL—Filed June 14, 1957

To the Clerk, United States Court of Appeals, Third Circuit, Philadelphia, Penna.

Please be advised that the plaintiffs in the above entitled case has this day filed Notice of Appeal to the United States Court of Appeals, Third Circuit, Philadelphia, Pennsylvania, from a Judgment or Decree of this Court by Honorable Francis L. Van Dusen.

Gilbert W. Ludwig, Clerk.

For Appellant: William R. Spofford, Esq., Charles S. Jacobs, Esq., Sherwin T. McDowell, Esq., Charles I. Thompson, Esq.

For Appellee: Harold K. Wood, Esq., U. S. Attorney.

[fol. 31]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,299, No. 12,300, No. 12,301

EMORY W. PARSONS and ERMA M. PARSONS,
Appellants in No. 12,299,

HOWARD H. PARSONS and MARTHA PARSONS,
Appellants in No. 12,300,

LAWRENCE H. PARSONS and GRACE E. PARSONS,
Appellants in No. 12,301,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania.

Appeal from the United States District Court for the Eastern District of Pennsylvania.

Argued December 19, 1957

Before: Biggs, Chief Judge; and Goodrich and Hastie, Circuit Judges.

OPINION OF THE COURT—Filed March 27, 1958

HASTIE, Circuit Judge.

These are appeals by taxpayers, who are partners in a business, from a judgment of the district court denying their several claims for refunds of income taxes paid upon their respective distributable shares of certain partnership income derived from coal mining. The appellants can prevail only if the involvement of the partnership, hereinafter called Parsons, in a strip mining enterprise was such as to [fol. 32] entitle the partners to deduct a depletion allowance,

pursuant to Sections 23 (m) and 114 (b) of the Internal Revenue Code of 1939 as implemented by Treasury Regulation 111, § 29.23 (m)-1, 26 Code Fed. Reg., 1949 ed., § 29.23 (m)-1, in computing partnership income from the mining operation. The problem presented is the often difficult, though familiar and recurring one of determining whether the person claiming a depletion allowance is "the owner of an economic interest in mineral deposits" within the meaning of Treasury Regulation 111, § 29.23 (m)-1.[1]

The almost simultaneous recent decisions of this court in *Commissioner of Internal Revenue v. Mammoth Coal Co.*, 1955, 299 F.2d 535, cert. denied 352 U.S. 824, and of the Court of Appeals for the Ninth Circuit in *Usibelli v. Commissioner of Internal Revenue*, 1955, 229 F.2d 539, have gone so thoroughly into this tax problem as it arises in the context of strip mining that we shall not elaborate again the basic concepts which are discussed in those cases. It is enough to repeat that the decisions make it clear that the economic interest in coal in place which will support a percentage depletion allowance for strip mining need not amount to an estate or tenancy as understood in the law of real property. Yet, it must be something more than an independent contractor's normal right to the benefit of his bargain and the kind of "interest" which that right always gives him in the subject matter of the contract. In characterizing an asserted interest a court will be guided by the total picture revealed by the facts of the case at hand.

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. . .

"Under such provisions [Secs. 23 (m) and 114], the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. . . . An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production." 26 Code Fed. Reg., 1949 ed., § 29.23 (m)-1.

[fol. 33] On this appeal the facts found by the district court are unchallenged. The Parsons firm is a contractor and over the years has engaged in road building, strip mining and the drilling of gas wells. Parsons derived the income involved in this case from strip mining conducted on land owned by the Rockhill Coal Co.

In preliminary negotiations Rockhill had proposed that Parsons undertake extensive stripping of the area in question under a detailed written contract and, to that end, Rockhill actually drafted a proposed contract. But Parsons refused to sign the agreement stating that it did not wish to be bound to a long term performance because, if opportunity should arise, it wished to return to road building. Accordingly, it was agreed that the partnership would proceed with stripping in the designated area under a terminable oral agreement. The essential provisions of that oral contract are set out in the trial findings.

The agreement defined the area to be mined but left the partnership free to work as it chose. The partnership understood that it was not obligated to mine the tract to exhaustion. Indeed, although operations under the oral agreement were conducted from time to time over an eight year period, the tract still contained much strippable coal when Parsons terminated its operations. Some of this coal was later mined by another contractor. Moreover, it was mutually understood from the beginning, in the light of the already mentioned desire of the partnership to be free to change from stripping to road building on short notice, that either party could terminate the oral agreement on ten days notice. In this connection it was understood that after notice of termination by the landowner the partnership would still be privileged to remove and the landowner obligated to accept usable coal from which the partnership had actually removed the overburden—this constituting the major part of the stripping operation—before the notice was received.

It was agreed that the partnership should deliver the coal it mined to Rockhill's railroad cars and to no one else. In [fol. 34] practice any coal which Rockhill rejected as unsuitable for its purpose was left in the pits as unsaleable. The parties agreed in advance upon a stipulated price per ton which Rockhill was to pay Parsons for usable coal.

This price was not geared to and did not vary with the market price of coal. However, the price could be and on occasion was altered to reflect increased costs of production.

Parsons made a considerable investment in movable equipment used in the Rockhill stripping operation. Early in the taxable period the partnership committed to this job its own equipment valued at some $210,000. At the same time it was using about $130,000 worth of Rockhill equipment under a rental agreement with the landowner. As the work progressed the partnership rented an increasing amount of Rockhill equipment and used less of its own. There is no indication that the partnership equipment had utility only for this job or was specially adapted to it.

We are satisfied that what the parties agreed and what they did disclose the partnership acting only as an ordinary independent contractor in mining the Rockhill tract. First, the matter of compensation was handled as in an ordinary contract job. The partnership had no freedom to sell or dispose of the coal to its own account. It was entitled only to an agreed price from the owner of the mining property. And since that price did not fluctuate with the market, there is nothing about the scheme of payment to indicate any interest of the contractor in the mineral. If we ask how this arrangement for payment to the partnership for its work differed from the normal payment to an independent contractor for accomplishing an agreed result, it is immediately apparent that there is no significant difference.

The other important factor on this record is the agreed duration of the enterprise. Here it is noteworthy that the partnership did not enter the job with any understanding that it would mine the tract to exhaustion, and that it did not in fact do so. Rather, it was concerned from the [fol. 35] beginning to remain free to discontinue stripping at any time. The terminability of the agreement on short notice was an essential and significant part of the bargain, not a mere formality inserted by some cautious draftsman. The logical conclusion from all of this is that the partnership contemplated and bargained for no economic interest in the mineral it agreed to extract beyond the independent contractor's normal concern with any subject matter with

which he is to work for an agreed price. True, the ten day notice could not be used to deprive Parsons of compensation for work it already had done in removing the overburden from particular coal. But this special limited right to complete work already far advanced does not destroy the character of the contract as one deliberately made terminable on very short notice.

The cases support this view of the matter. While the courts characteristically look at the entire context in deciding whether mining contractors have depletable interests in the mineral in place, the stripper usually bases his claim upon one or both of the factors discussed above. In some circumstances the stripper's right to mine the deposit to exhaustion, or even for a rather considerable period without particular reference to exhaustion, is stressed. See *Commissioner of Internal Revenue v. Mammoth Coal Co., supra; Stilwell v. United States,* 4th Cir., 1957, 250 F.2d 736; *Winfield Mining & Contracting Co.,* 1954, 13 TCM 571; *James Ruston,* 1952, 19 T.C. 284; *cf.* G.C.M. 26290, 1950-1 Cum. Bull. 42. In others the fact that the stripper's income from the mining operation varies in accordance with the market price of the mineral makes his claim of depletable interest persuasive. See *Commissioner of Internal Revenue v. Gregory Run Coal Co.,* 4th Cir. 1954, 212 F.2d 52, cert. denied, 348 U.S. 828 (Vincent-Swaney contract); *Virginia B. Coal Co.,* 1956, 25 T.C. 899; *Paul E. Barry, Inc.,* 1955, 14 TCM 37; *Winfield Mining & Contracting Co., supra; James Ruston, supra.* But see *C. A. Hughes & Co.,* 1955, 14 TCM 172. But unless some such special circumstance ap- [fol. 36] pears, differentiating the arrangement from the ordinary contract job, there is analytically no basis upon which the stripper, who has no conventional property in the mineral, can claim a depletable interest therein.

Appellants attach much significance to recent borderline cases in which the Court of Appeals for the Fourth Circuit has found that contractors engaged in strip mining on land of others were entitled to depletion allowances. See *Stilwell v. United States, supra; Commissioner of Internal Revenue v. Gregory Run Coal Co., supra; Weirton Ice & Coal Supply Co. v. Commissioner of Internal Revenue,* 4th Cir. 1956, 231 F.2d 531; *Commissioner of Internal Revenue*

v. Hamill Coal Corp., 4th Cir. 1956, 239 F.2d 347. That court has certainly gone as far as any other in recognizing depletable interests in strippers. But in the cited Fourth Circuit decisions we find repeated emphasis upon the court's factual conclusion that the real understanding of the parties was that the strip miners would be allowed to exhaust the mineral, or at least to continue stripping operations for a very substantial time. Only in one of the arrangements considered in *Commissioner of Internal Revenue v. Gregory Run Coal Co., supra,* does this factor seem to have been absent. And there the owner and the strip miner had formalized their relationship in an agreement terming the strip mining project "this joint adventure." How much weight the court accorded this indication of the way the parties themselves viewed their relationship, we do not know. Perhaps no more can be said than that distinguishing facts usually prevent reasoning by analogy from being very helpful in borderline cases. In any event, we think the reasoning of the Fourth Circuit cases requires the stripper to marshal more significant indicia of interest in the mineral than the present record will yield.

One other point deserves separate mention. In these mining cases the allowance of a percentage depletion deduction from gross income for tax purposes is premised on the conception that a tax free recovery of capital actually [fol. 37] invested in a wasting mineral deposit is fair. See *Commissioner of Internal Revenue v. Southwest Exploration Co.*, 1956, 350 U.S. 308, 312. The commitment of capital as an investment in the exploitation of a given mineral deposit must be real and unequivocal. Otherwise, mining contractors, like contractors generally, must look to "receive" their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working." See *Usibelli v. Commissioner of Internal Revenue, supra,* 229 F.2d at 541.

Here the only thing set up as a capital investment in the Rockhill coal deposits is Parsons' purchase of a considerable quantity of movable equipment, accompanied by the rental of other equipment from Rockhill. There has been no showing that this equipment was specially adapted

to this job or that it would not be suitable thereafter for such other undertakings as constituted the normal and familiar business of this contractor. Thus, quite apart from considerations relating to compensation and the terminability of the contract, it is very doubtful whether investment in equipment of general utility in a contractor's business is the type of capital expenditure which can properly be found to constitute an investment in a particular mineral deposit which the contractor has undertaken to work.

For these reasons we agree with the district court that the tax refund claims in suit are not well founded.

The judgment will be affirmed.

[fol. 38] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12300 (D.C. 15230)

EMORY W. PARSONS and ERMA M. PARSONS, Appellants,

vs.

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

JUDGMENT—March 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

/s/ Ida O. Creskoff, Clerk.

March 27, 1958

[fol. 39] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12300 (D.C. 15230)

HOWARD H. PARSONS and MARTHA PARSONS, Appellants,

vs.

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

JUDGMENT—March 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

/s/ Ida O. Creskoff, Clerk.

March 27, 1958

[fol. 40] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12301 (D.C. 15231)

LAWRENCE H. PARSONS, and GRACE E. PARSONS, Appellants,

vs.

FRANCIS R. SMITH, former Collector of Internal Revenue for the First District of Pennsylvania.

JUDGMENT—March 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

/s/ Ida O. Creskoff, Clerk.

March 27, 1958

[fol. 41]

IN UNITED STATES COURT OF APPEALS

MOTION FOR EXTENSION OF TIME TO FILE PETITION FOR REHEARING AND ORDER GRANTING SAME—April 10, 1958 (omitted in printing)

[fol. 42a] [File endorsement omitted]

[fol. 43]

IN UNITED STATES COURT OF APPEALS

PETITION FOR REHEARING—Filed April 25, 1958

Appellants, Emory W. Parsons, Erma M. Parsons, Howard H. Parsons, Martha Parsons, Lawrence H. Parsons, and Grace E. Parsons, petition for rehearing pursuant to Rule 33 of the Rules of this Court.[1]

During the taxable years in question Appellants Emory W. Parsons, Howard H. Parsons, and Lawrence H. Parsons were partners in an enterprise engaged in the business of strip-mining coal in the bituminous regions of Pennsylvania. The issues with respect to which suits were filed by the partners and their respective wives related to the right of the partnership to claim a deduction for percentage depletion with respect to amounts received by the

[1] Upon Motion, the time for filing a Petition for Rehearing was extended to April 25, 1958.

partnership for coal stripped by it and delivered to Rockhill Coal Company ("Rockhill") during the taxable years in question, thereby reducing each partner's distributable share of partnership net income. In its decision filed March 27, 1958, the Court determined that the partnership was not entitled to a deduction for depletion. For convenience, the partnership is hereinafter referred to as "Parsons".

Rehearing is respectfully requested on the following grounds:

(1) The opinion of the Court rests upon three grounds, two of which are, we submit, inconsistent with the Court's earlier decision in *Commissioner v. The Mammoth Coal Company*, 229 F. 2d 535 (3rd Cir. 1955), rehearing denied, 229 F. 2d 539 (1956), cert. den., 352 U. S. 824 (1956). The third ground, we submit, fails to give sufficient weight to certain facts in the record. Specifically:

(a) The Court relied in part upon the fact that Parsons received a stated price per ton of coal mined and delivered to Rockhill, rather than a price which fluctuated with the market. The effect of the Court's reliance upon [fol. 44] this fact appears to negate its earlier decision in *Mammoth*, wherein the Court had stated (229 F. 2d at 538-9):

> "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the [owner] should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

The Court's action is difficult to understand in view of the fact that both parties conceded on brief that the method of payment is irrelevant. Thus, the Court has on its own motion resurrected an issue which both parties believed had been conclusively laid to rest in *Mammoth*.

Indeed, the Commissioner has significantly changed his position in this respect in his proposed regulations under the Internal Revenue Code of 1954. For many years

his Regulations provided that a taxpayer, to possess an economic interest, must derive income from the "severance *and sale*" of the mineral.[2] His proposed regulations under the 1954 Code recognize that there need be no relationship between the market price and the price paid to the stripper by providing that an economic interest is possessed in every case where the taxpayer secures income derived from the "severance *or sale*" of the mineral.[3]

(b) The Court relied in part upon the fact that Parsons had no capital investment in the enterprise beyond the dedication of some $300,000 of equipment (either purchased or leased) to the job. In the Court's view, it was "very doubtful whether investment in equipment of general utility in a contractor's business is the type of capital expenditure which can properly be found to constitute an investment in a particular mineral deposit which the contractor has undertaken to work". This statement by the [fol. 45] Court is, we submit, inconsistent with its earlier decision in *Mammoth*, where the stripper's investment was of precisely the same nature. Indeed, under the Court's new view, *no* stripper would have the requisite capital investment, for virtually all stripping equipment is suitable for building roads and similar work.

The fact that Parsons may have been entitled to depreciation deductions does not alter the conclusion that it had an economic interest in the coal. No one would dispute the proposition that if Rockhill had undertaken the operation as fee owner of the mineral, it would have been allowed deductions for *both* depletion and depreciation. It is likewise obvious that Parsons could receive no tax benefit from depreciation deductions unless it was successful in finding marketable coal, and received gross income against which the deductions could be applied. Parsons' investment in the mineral was its undertaking to stake its know-how, payroll, and equipment in the enterprise on the gamble that marketable coal could be discovered and exploited.

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[2] U. S. Treas. Reg. 118, § 39.23(m)-1(b).

[3] Prop. Reg. § 1.611-1(b)(1).

(c) Finally, the Court relied in part upon the fact that Parsons' contract with Rockhill was terminable by either party upon ten days' notice. The fact that Parsons had an indefeasible right to strip uncovered coal was minimized on the ground that "this special limited right to complete work already far advanced does not destroy the character of the contract as one deliberately made terminable on very short notice." As a practical matter, the right had considerable value, and would have permitted Parsons (had Rockhill terminated) to strip and sell to Rockhill substantial quantities of coal from every cut.

In connection with its discussion of the terminability feature of Parsons' contract, the Court discussed the line of recent decisions in the Court of Appeals for the Fourth Circuit. Although the Court termed these decisions "borderline cases", it is difficult to conceive of a decision more squarely in point and more contrary to the present decision [fol. 46] than the Fourth Circuit's holding in *Weirton Ice and Coal Supply Company v. Commissioner*, 231 F. 2d 531, 535-36 (4th Cir. 1956), wherein the Court stated:

> "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 in the enterprise. It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all of the taxable years. We think that Weirton's rights were dependent solely upon the extraction and delivery of the coal, and that the relationship of the parties to the ore in place gave it an economic interest in the mineral and entitled it to share with National the depletion allowance provided by the statute."

The emphasis of the Court in *Weirton* was not upon the right of the stripper to mine forever, but upon the fact that the stripper had actually mined the coal with respect to which depletion allowances were sought. Not only did Parsons mine the coal during the taxable years, but that coal which it did so mine was coal which (having been un-

covered) it had an enforceable right to mine and sell despite any action which Rockhill might take. It is submitted that the Court has too greatly minimized not only the value, but also the indefeasible nature of Parsons' right to strip uncovered coal.

(2) The Court's decision, we submit, gives insufficient weight to the fundamental purpose of the depletion allowance, which is to reward those who bear the risk of discovering the mineral.[4] Nowhere in its opinion does the Court recognize the often repeated direction of the Supreme Court of the United States, that depletion deduc-[fol. 47] tions are to be allowed in "every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." *Palmer v. Bender,* 287 U. S. 551, 557 (1933).

The Congressional policy to encourage the discovery and exploitation of the Nation's natural resources extends to every miner, regardless of the size of the enterprise, if he must look for his income to the " 'possibility of profit' from the use of his rights over production, 'dependent solely upon the extraction and sale' " of the mineral. *Burton-Sutton Oil Company v. Commissioner,* 328 U. S. 25, 34 (1946).

It is clear beyond dispute that Parsons falls within the foregoing Congressional policy as implemented by the Supreme Court. The Court's assumption that Parsons was no different from the ordinary independent contractor is, we submit, erroneous. Some stripping contractors operate under cubic yardage contracts and are paid whether or not they are successful in finding coal. As to them, the Court would be correct in denying depletion allowances. Parsons' arrangement, however, was wholly different. Under its contract it received no income whatever unless and until it was successful in finding and producing marketable coal. Manifestly, therefore, to it must belong the

[4] Sen. Rep. No. 617, 65th Cong., 3rd Sess., 1939-1 (Part 2) Cum. Bull. 122; H. R. Rep. No. 1, 69th Cong., 1st Sess., 1939-1 (Part 2) Cum. Bull. 319.

reward granted by Congress to entrepreneurs who prospect for and produce minerals at the risk of losing their entire investment if they are unsuccesful.

The Court's opinion proceeds upon the premise that since Parsons was like the ordinary contractor, some special provision must be found in its contract to entitle it to depletion allowances. The premise, we submit, is incorrect. Since Parsons' income was entirely dependent upon the discovery and production of coal, and since it bore the entire risk of the enterprise, it falls four square within the [fol. 48] class intended to be encouraged and benefited by the depletion allowance. No further ingredient need be added.

For all of the foregoing reasons, it is respectfully requested that a rehearing be granted.

Wililam R. Spofford, Sherwin T. McDowell, Charles I. Thompson, Jr., Attorneys for Appellants.

Ballard, Spahr, Andrews & Ingersoll, of Counsel.

[fol. 49]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,299, No. 12,300, No. 12,301

EMORY W. PARSONS and ERMA M. PARSONS,
Appellants in No. 12,299,

HOWARD H. PARSONS and MARTHA PARSONS,
Appellants in No. 12,300,

LAWRENCE H. PARSONS and GRACE E. PARSONS,
Appellants in No. 12,301,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania.

SUR PETITION FOR REHEARING

Present: Biggs, Chief Judge; and Maris, Goodrich, Staley and Hastie, Circuit Judges.

OPINION OF THE COURT ON DENIAL OF PETITION FOR REHEARING—May 29, 1958

Per Curiam:

This petition for rehearing raises no point of substance that has not already been considered and decided against the petitioner. Accordingly, the petition is denied.

[fol. 50] KALODNER, Circuit Judge, dissenting.

I am of the opinion that a rehearing should be granted, and the judgment of the district court reversed.

This result is required for the reasons I have given in my dissenting opinion in the Huss cases.

The taxpayers here, as in the Huss cases, were granted an exclusive right to remove all the merchantable coal in place in the reserved or leased area. They had a right of control over production of the mineral in place which gives rise to the economic interest necessary for the depletion allowance. Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 29, 32 (1946). All the coal involved was produced during the existence of this interest. The fact that such interest might have been brought to an end some day in the future is not a relevant consideration.

[fol. 51] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

[Title omitted]

ORDER DENYING PETITION FOR REHEARING—May 29, 1958

After due consideration the petition for rehearing in the above-entitled cases is hereby denied.

Dated: May 29, 1958

[fol. 52] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 53]

SUPREME COURT OF THE UNITED STATES

[Title omitted]

ORDER ALLOWING CERTIORARI—October 13, 1958.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted. The case is consolidated with No. 305 and a total of two hours allowed for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1958

No. 305

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS,

vs.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 25, 1958
CERTIORARI GRANTED OCTOBER 13, 1958

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1958

No. 305

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS,

vs.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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[fol. 1]

IN UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Appellants' Appendix

RELEVANT DOCKET ENTRIES

Feb. 4, 1953.	Complaint filed.
Feb. 4, 1953.	Summons exit.
Mar. 5, 1953.	Summons returned "on February 5, 1953 served Francis R. Smith and United States Attorney and on February 10, 1953 served Attorney General and Commissioner of Internal Revenue by registered mail" and filed.
Aug. 20, 1956.	Stipulation of Facts filed.
Apr. 6, 1957.	Stipulation extending time for filing answer, etc. to 6/4/53 and Order approving same filed. 4/7/53 noted (Grim)
Oct. 2, 1957.	Answer filed.
Nov. 25, 1957.	Trial—Witnesses sworn (cont. to 12/22/55).
Dec. 7, 1957.	Transcript of Testimony filed.
Jan. 11, 1957.	Motion and notice of, for leave to file amended complaint filed.
Feb. 7, 1957.	Plaintiff's requests for findings of fact and conclusions of law filed with the Court on 1/10/57,
Feb. 11, 1957.	Defendant's objection to Plaintiff's motion for leave to amend the Complaint filed.
Mar. 26, 1957.	Opinion Van Dusen, J. sur pleadings and proof with findings of fact and conclusions of law, filed.

Mar. 26, 1957. Order of Court denying motion for leave to amend, filed. (noted and notice mailed 3/27/57).

[fol. 2]

Apr. 25, 1957. Stipulation and Order of Court suspending Order of Court filed 1/11/57 until final judgment is entered in accordance with Opinion of Court dated 3/26/57 filed. (noted and notice mailed 4/26/57).

May 28, 1957. *14775*—Judgment in favor of Defendant against Plaintiff on years 1944 and 1945, and in favor of Plaintiff against Defendant on year 1946 in $625.77 plus interest from 3/15/47 and for year 1947 in $1134.66 plus interest from 3/2/48, each party to bear own costs, and issuing certificate of probable cause, filed. (5/31/57 noted and notice mailed).

May 28, 1957. *14776*—Judgment in favor of Defendant against Plaintiff for years 1944 and 1945, and in favor of Plaintiff against Defendant for years 1946 in $624.93 plus interest from 3/15/47 and 1947 in $1134.67 plus interest from 3/2/48, each party to bear own costs, and issuing certificate of probable cause, filed. (5/31/57 noted and notice mailed).

May 28, 1957. *14777*—Judgment in favor of Defendant against Plaintiff for years 1944 and 1945, and in favor of Plaintiff against Defendant for year 1946 in $625.78 plus interest from 3/15/47 and for year 1947 in $1134.67 plus interest from 3/2/48, each party to bear own costs, and issuing certificate of probable cause, filed. (5/31/57 noted and notice mailed).

[fol. 3]

Excerpts From Testimony

Russell Huss, having been duly sworn, was examined and testified as follows:

Direct examination.

By Mr. Berger:

Q. Where do you live, Mr. Huss?
A. Ringtown, Pennsylvania.
Q. What county is that?
A. Schuylkill County.
Q. Now, during the years 1944 to 1947, inclusive, what was your occupation?
A. Strip mining.
Q. What is your present occupation?
A. Strip mining.
Q. Did you engage in the strip mining operation in Schuylkill County during the years 1944 to 1947 with your brothers?
A. I did.
Q. Their names are George Huss and Wesley Huss; is that right?
A. That's correct.
Q. You and your two brothers had a partnership?
A. We did.
Q. You had a partnership.
It is because of the strip mining operations which were carried on by you and your two brothers as a partnership that these three lawsuits are brought; isn't that correct?
A. That is correct.
Q. Now, were there two companies with whom, during the period here in question, you and your brothers as partners did business?
A. Yes.
Q. As strip miners.
What were the two companies?

[fol. 4] A. Philadelphia and Reading Coal and Iron Company and Stevens Coal Company.

Q. Now, during the years from 1944 to 1947, inclusive, in what areas were you and your brothers strip mining?

A. We were stripping in the Good Springs area known as the Tower City Tract.

Q. What county in Pennsylvania?

A. That would be Schuylkill County.

Q. Since 1947, by the way, did you continue to do strip mining for the Philadelphia and Reading Coal and Iron?

A. Yes.

Q. Until when?

A. Until 1953.

Q. I see. All right.

Will you tell me——

Mr. Berger: May I have this marked for identification?

(A document purporting to be contract between the Philadelphia and Reading Coal and Iron Company and George W. Huss Contracting Company, identified as Stripping No. P-22, was marked as Exhibit P-1 for identification.)

By Mr. Berger:

Q. You entered into certain written contracts with the Philadelphia and Reading Coal and Iron Company, did you?

A. That is correct.

Q. I will now show you Plaintiff's Exhibit No. 1 for identification and ask you whether or not this contract was the first of the contracts which you had entered into—that is, you and your brothers—with the Philadelphia and Reading Coal and Iron Company with reference to the stripping operations beginning in 1944?

A. That is the first contract.

[fol. 5] The Court: Have you given that to the stenographer to mark, Mr. Berger?

Mr. Berger: Yes, Your Honor. It has been marked as P-1.

The Court: All right.

Mr. Berger: Your Honor, so that we won't get too confused here, let me say that the Coal Company has designated this as P-22.

Off the record.
The Court: Yes.

(Discussion off the record.)

The Court: What is the date of the contract?
Mr. Berger: Let me see. The date of the contract is——
The Court: May 27, 1944?

* * * * * * *

Mr. Fink: Your Honor, in all candor, I believe that with this case, with the developing state of the law which Your Honor may be instructed on from the Third Circuit, since we are letting one contract stand for about nine, I believe it would be most advisable, Your Honor, to have the one contract in its entirety go in.

It is almost impossible to say what the Third Circuit might pick up as a relevant feature of this contract that we at this time would not regard as such.

The Court: Still I would like to have Mr. Berger designate which articles he considers are pertinent, and in due course I would like to hear from you in writing, in a letter which I will attach to the record, which articles you think are pertinent.

Mr. Berger: Off the record——
The Court: Yes.

[fol. 6] (Discussion off the record.)

Mr. Berger: I should say Articles 1, 2, 5, 7, 9, 10, 11, 16, 17, 19, 22, 29, 37, and 39.

* * * * * * *

By Mr. Berger:

Q. How deep do you go in your strip mining operation in fact, not in reference to this map, but in fact how deep do you cut?

A. Why, our cuts will run as deep as 145 feet.

Q. In other words, beginning at the surface, in some instances you went as deep as 145 feet?

A. Yes.

* * * * * * *

By Mr. Berger:

Q. In other words, what is your testimony with respect to the manner in which you got compensated? You got paid per ton of coal; is that correct?

A. That is correct.

Q. And you had no other basis for compensation whatever?

A. None whatever.

Q. In Exhibit P-1, the original price per ton of coal which you received is stipulated at $1.75; is that correct?

A. That is correct.

Q. Were there supplementary agreements which increased that price?

A. Yes, there were.

* * * * * * *

Mr. Berger: Now it is agreed that the price which previously was $1.75 per ton under the agreement marked P-1 in this record was subsequently increased to $1.85 per ton and then increased to $2.00 per ton. That is correct, isn't it?

Mr. Fink: That's correct.

[fol. 7] By Mr. Berger:

Q. Tell His Honor what brought about the increase.

A. Well, there is a stipulation there in the contract that says if there is an increase in labor, there will be an increase in the price of coal. Now, if the labor increase came along, the price of coal was raised up allowing the coal companies to allow more money.

By the Court:

Q. That is your labor, is it?

A. That is my labor.

Q. Your labor costs. If your labor costs increased, under the terms of the original contract you were to be allowed a larger price per ton; is that correct?

A. That is correct, Your Honor.

Q. So that the first supplemental agreement was just carrying out that provision in the original contract?

A. That is correct.

Q. You say that is because of your increased labor costs. Subsequently, there was a second supplemental agreement which increased it further because of a further increase in your labor costs?

A. That is correct.

The Court: Could we have the dates of those two supplemental agreements?

Mr. Berger: Yes, Your Honor.

The first supplemental agreement was the 20th of August 1945.

The second supplemental agreement was the 28th of October 1946.

* * * * * * *

By Mr. Berger:

Q. Mr. Huss, how long have you been in the coal business?

A. Since 1937.

[fol. 8] Q. And are you now and were you in 1945 and thereafter, familiar with the market conditions in the coal industry, the hard coal industry?

A. Yes.

Q. And are you familiar with the bargaining between the United Mine Workers and various operators like yourself?

A. Yes, I am.

Q. Is it a fact that the United Mine Workers demanded more money from you?

A. Yes.

Q. What effect did the increase in wage payments and wage scales have, to your personal knowledge, on the price of coal on the open market?

A. Well, the price always rose.

By the Court:

Q. Always rose when?

A. After the new United Mine Workers' agreement.

Q. Suppose the United Mine Workers' agreement de-

creased the price to be paid to the members of the Union, then it wouldn't rise, would it?

A. There is a provision in the contract; or there was, that allowed for that, but during those years it never happened. It has not happened since.

Q. In other words, it was contingent on the cost-of-living index, was it?

A. I would say yes.

Q. The cost of living was constantly going up so that the cost the miners got was going up; is that correct?

A. That is correct.

Q. Whenever there was an increase, there would be an increase in the price of coal within the next six months, or how soon after that?

A. Sometimes within the next three months, depending—during those years there was a lot of times when the coal companies had to go to the Government to be allowed [fol. 9] an increase in the sale price of the coal, and sometimes that would take as much as six months, but they would finally get it.

The Court: Mr. Fink, did you have anything you wanted to say? If you want to make a motion to strike, you feel perfectly free to make any motion you wish. I will be happy to listen.

Mr. Fink: It is a confusing way to go at some thing. He has shown no connection between——

The Court: He has not asked the question yet relating to this. He is establishing this witness' knowledge of the general pattern of the price of coal, as affected by the amount paid to the miners.

Mr. Fink: I will accept the witness' statement, subject to cross-examination.

By Mr. Berger:

Q. Are you prepared to testify what happened when the United Mine Workers demanded an increase and the market did not permit an increase in the sale price of the coal?

A. Well, in these years that has never happened.

Q. Has it happened since those years?

A. There hasn't been an increase in recent years but the market price of the coal has been reduced to some extent.

Q. What effect did the reduction in the market price of the coal have on your operations with the Philadelphia and Reading Coal and Iron?

A. At the present, today, we have no operations for the Philadelphia and Reading Coal and Iron.

Q. Now, getting back to the equipment you had on this operation, were there any buildings that were constructed?

A. Yes, we had to construct buildings, shops, supply houses.

[fol. 10] Q. Now, was there any back-filling required to be done under these contracts?

A. Not in those years, there was not.

Q. All right.

How long did you continue to strip mine under these various contracts?

A. Until it wasn't any longer profitable to strip.

Q. When you reached that point, what happened?

A. We stopped.

Q. Now, it has been pointed out that there is a cancellation clause in this agreement. Are you familiar with that cancellation clause?

A. Yes, I am.

Q. Now, did you have any discussions with any representative of the Philadelphia and Reading Coal and Iron with reference to that cancellation clause at the time you were negotiating the contract, the first contract?

A. Yes, I did.

(sic) Tell His Honor what those discussions were.

Mr. Fink: I am going to object if it is an effort to vary the terms of this written instrument.

* * * * * * *

Will you proceed, Mr. Berger?

By Mr. Berger:

Q. Mr. Huss, with reference to the cancellation clause, did you have any discussion or discussions with representa-

tives of the Philadelphia and Reading Coal and Iron Company?

A. Yes, I did, because when I saw that cancellation clause in there, I was concerned about it.

Q. Who were the representatives?

A. Charlie Brown and Bill Mulhoff of the Engineering Department. I talked to them.

Q. Is Mr. Brown in court today?

A. Yes, he is.

[fol. 11] Q. What was stated in this conversation?

A. Well, the first thing I wanted to know is if I moved in on the property and started to work, I may spend ten, twenty, thirty thousand dollars moving in, if they could cancel out at any time with a 30-day notice.

He told me that provision was put in there in a form contract so as if they got hold of a contractor who was not reputable, who wouldn't live up to the contract, they could put him off the property without court action.

By the Court:

Q. Now, when was this conversation?

A. Before I signed the contract.

Q. Before May of 1944?

A. Your Honor, I think that contract was made in May. I don't know whether it was signed exactly on that day. I think it was sometime later.

Q. It is dated May 27, 1944.

When do you think it was signed?

A. Possibly a week or two after that.

Q. You think it was during that week or two that you had this conversation with Mr. Brown and Mr. Mulhoff?

A. That is correct.

Q. Where was the conversation?

A. At the offices of the Philadelphia and Reading Coal and Iron Company in Pottsville.

Q. In Pottsville.

Was there anyone present at the conversation except you and Mr. Brown and Mr. Mulhoff?

A. There could have been some other men there. I wouldn't recall just who they were.

Q. Was there anybody with you as far as you remember?
A. My brother, George.
Q. Your brother, George?
A. That is correct.
Q. Was there any further discussion on this matter [fol. 12] prior to the signing of subsequent contracts or was this the only time it was discussed?
A. That was the only time it was discussed.

By Mr. Berger:

Q. Now, did you thereafter move your equipment on and build the roads?
A. Yes.
Q. Was this contract or any subsequent contract ever cancelled out by the Philadelphia and Reading Coal and Iron alone?
A. No.
Q. Did you perform your obligations under the contract?
A. I did.
Q. Was this contract, which is in the record as P-1, after the completion of this strip mining, cancelled by mutual agreement?
A. Yes.
Q. When?
A. Well, there are so many of them I would have to look at the dates of them.

Mr. Berger: I am showing the witness, Your Honor——
The Witness: The 31st——
The Court: Let Mr. Fink see the document you are showing him.
The Witness: The 31st day of October 1947.
Mr. Berger: May I state for the record, Your Honor, this Cancellation of Agreement is physically attached to P-1.
The Court: That will go in the record, together with the other relevant portions of P-1?
Mr. Berger: Yes, Your Honor.

[fol. 13] By Mr. Berger:

Q. Mr. Huss, who determined when and where to begin the mining in a particular area?

A. In those areas I did.

Q. Who determined when and where to stop the mining?

A. I did.

Q. Who paid the men who did the work in this operation?

A. I did.

Q. Who paid for all of the supplies and materials?

A. I did.

Q. Who paid for the equipment?

A. I did.

Q. Now, did there come a time in your relationships with the Philadelphia and Reading Coal and Iron where, after strip mining, you uncovered coal and delivered the same to the Philadelphia and Reading Coal and Iron, and they rejected it?

A. Yes, there was, in later years.

Q. Tell His Honor briefly what the situation was. First of all, was it under a similar contract?

A. It was under a similar contract, and the coal was of such a quality that they said they couldn't use it at their plant, and at that time I made an agreement with another colliery to take the coal, subsequent to the Reading's agreement that it would be all right to sell it, and the Reading paid me the money under the agreement that I had with the coal company. They collected off the coal company and paid me my share of the money at that particular time.

* * * * * * *

By Mr. Berger:

Q. What was retained by the Philadelphia and Reading Coal and Iron? Was so much per ton retained?

A. I don't know what the agreement was, but whatever the royalty was at that time was what they kept out of it.

[fol. 14] Q. The rest was remitted out to you?

A. That is correct.

By the Court:

Q. Who is "they"? Who is keeping this? Did the Philadelphia and Reading Coal and Iron's authorized representative tell you they retained something from the amount they got from this other company that was going to use the coal?

A. That's right.

Q. That is what you are calling a royalty?

A. That's right.

Q. They remitted to you the contract price per ton; is that correct?

A. That's right.

Q. You got your full contract price per ton that was provided in the contract?

A. I am assuming yes. I don't know.

Q. You aren't sure whether you got your full contract price per ton or not?

A. No, I am not quite sure. I think I did, but I am not quite sure.

By Mr. Berger:

Q. Who negotiated a price with the other company that bought the coal?

A. I negotiated the price with the other company.

* * * * * * *

[fol. 20] Q. Suppose you delivered coal that was not accepted. Could you get paid then?

A. Well, in those years we never had any coal that was rejected. The market was on the increase, and coal was moving rapidly all along.

Q. Now, did any other person have the right to strip mine either the Stevens or the Philadelphia and Reading areas where you did your prospecting and strip mining?

A. No.

Q. In respect to either the Stevens or the Philadelphia and Reading, were your strip mining operations ahead of or behind the requirements of the coal company, that is, the Philadelphia and Reading Coal and Iron, or the Stevens?

A. Most of the time they were ahead.

Q. Explain that to His Honor.

A. Well, at times I have had as much as 50,000 ton of coal above ground waiting for shipment.

Q. In terms of days and months production, what would that be, 50,000 tons of coal?

A. Well, at the rate that I was shipping at that time, it would be somewhere around 40 working days' supply ahead.

Q. I would like to clarify one thing. In your testimony you have used the personal pronoun "I." "I paid." What did you mean by "I"?

A. When I expressed myself as "I," I mean my brothers and myself.

* * * * * * *

Cross examination.

By Mr. Fink:

* * * * * * * *

Q. Incidentally, can any of this equipment be used for other purposes than coal stripping?

[fol. 21] A. Not very well. It is not adaptable to other types of work, other than possibly the bulldozers and the trucks, possibly.

Q. The trucks can be used for other things?

A. In most cases, the trucks are so heavy you cannot license them on the highway.

Q. Isn't any of this equipment ever used in ordinary highway construction?

A. Not as I can recall any of it being used today.

Q. The trucks are not used in highway construction?

A. Today you can't use the trucks in highway construction unless it is completely off-the-road construction.

Q. Do you know of any stripping contractors who simply enter into an arrangement with the owner of coal land for a certain fee that they will remove this overburden?

A. Yes, there are some operations that pay for the removal of overburden at one figure and the loading and hauling of the coal at another figure.

Q. Has your partnership ever entered into any such arrangements?

A. Never.

Q. You testified on direct examination that you were not compensated for the removal of the overburden; is that correct, sir?

A. That is correct. You don't get paid for removing overburden.

Q. How do you know, sir, that the price paid to you per ton of coal removed did not include a factor for what you had been put to to remove the overburden?

A. Well, there is no question in my mind that the factor is there, but whether the coal, after you remove the overburden, is in sufficient quantities to compensate you for the amount of overburden you remove, you never know until you have removed the overburden.

Q. But you feel that at least the cost that you have been put to in removing the overburden is reflected in the price per ton of coal you will receive if you find the coal?

[fol. 22] A. That's right.

Q. Before these contracts were let, sir, did the Philadelphia and Reading Coal and Iron Company furnish you with any maps of the area?

A. Surface maps.

Q. Did they give you any studies or maps or estimates of the amount of recoverable coal therein?

A. I can't recall it on this particular property that they gave us any estimates as to the amount of coal that was there.

Q. When you say "this particular property," you are referring to the five Tower City stripping tracts?

A. That is correct.

Q. You do not recall if the Philadelphia and Reading Coal and Iron Company gave you any maps or estimates or studies to indicate to you how much marketable coal was believed to be in those tracts?

A. To the best of my knowledge, I don't ever recall of any estimate from the coal company as to the tonnage of coal that would be derived from this stripping.

Q. They gave you maps, did they not, showing you that coal veins——

A. As we term it, surface maps, yes.

Q. I am sorry. I misunderstood you. That is what you mean by the surface maps?

A. The surface map shows where the veins are or where they are supposed to be.

Q. In part, sir, the Philadelphia and Reading Coal and Iron Company gave you that information from the fact that it has been engaged in working in areas adjacent to that area; is that correct?

A. In some cases they get it from direct mining. In other cases, they get it from direct proving.

In this particular property, there were four—or five veins that had been mined on one dip. On the other dip, there hadn't been any mining. It was all virgin territory. So, therefore, that had to be proved.

[fol. 23] Q. How many of the five tracts represented virgin territory when you entered on them?

A. Well, there was—on all of the tracts there was parts of them that had been mined.

* * * * * * *

Q. You testified that the deepest you went in removing overburden was 145 feet?

A. That's correct.

Q. What was the average removal?

A. The average of that was about 110 feet.

Q. 110 is average throughout the tract?

A. Yes.

Q. Do you know, sir, how much it cost you to remove the overburden on P-22?

A. No, I can't tell you that without going back over my figures.

Q. You can't tell me about any of the area?

A. Well, you have all types of overburden on different veins, and your cost of removing rock is lots higher. It is more than twice what it is to remove clay overburden.

Q. So you can't give us any figures without checking your records; is that correct, sir?

A. No, that I would want to do at this time.

Q. How soon after you entered on P-22 were you producing coal?

A. I would say in the neighborhood of about three weeks I was producing a small amount of tonnage.

Q. When did the tonnage start stepping up?

A. Well, I was there at least two months before I got

tonnage that would compensate me and give me a small profit.

Q. How long did you strip on P-22?

A. I stripped there until I completed the P-22 contract.

Q. Do you recall when that was?

Q. (sic) No, I don't, because in between they came in on P-22b, and I moved from one to the other as the veins fol- [fol. 24] lowed through, from one tract to another. I followed through on the veins, and I would come back on that.

Q. How about P-29? When did you start producing coal after your entry on that?

A. I produced some coal off of P-29 shortly after the contract was signed. I don't recall the date of that.

Q. P-32?

A. P-32 was, if I am recalling rightly, over the mining area that there wasn't too much of a problem of finding out where the coal was. The problem was how much was there and how much you could recover.

Q. Did the Philadelphia and Reading Coal and Iron Company have a right to send inspectors on the property?

A. Yes, they did.

Q. Did they exercise that right?

A. Occasionally.

Q. Did they have any right to direct you as to what you should do?

A. Only as far as the contract stated or to the amount of overburden to be removed to the ton of coal, and that was an average over an area.

Q. When you entered into these contracts, what was your estimate of how long it was going to take you to complete them?

A. I had no idea because it wasn't proven in any way, shape, or form, and it was a case of how much coal will you find.

Q. Did you think of it as a contract that might last as much as two to three years?

A. When I went into 22-b, I figured that contract would last between a year and a half and two years, depending, of course, on what coal could be located.

• • • • • • •

Q. Did you have any concern with whether or not the Philadelphia and Reading Coal and Iron Company had sold that coal after you delivered it to them?

[fol. 25] A. I would be concerned to the extent if they didn't sell it I didn't deliver any more.

* * * * * * *

Q. Now, sir, with reference to this conversation about the termination clause on P-22, do you distinctly recall this conversation?

A. Yes, I do.

Q. How soon before you had entered into that contract did this conversation take place?

A. When I got those contracts and read them over, I immediately asked about that particular paragraph in there.

As I said before, I didn't feel I wanted to move equipment on to a job and spend a certain amount of dollars moving it and find out after I had been there I would be put off in 30 days where I would not ever have a chance to get back the money I was investing.

Q. You were not advised by a lawyer?

A. At that time we had no lawyer. We took the men at their word.

Q. Who were you talking to at this time?

A. Charles Brown and Mr. Mulhoff.

Q. Mr. Brown is the man in the court room?

A. Yes he is.

Q. And the other man?

A. Bill Mulhoff. He isn't here today.

Q. Is he alive?

A. Yes.

Q. Did you know what their positions of authority were with the Philadelphia and Reading Coal and Iron Company?

A. Bill Mulhoff was chief engineer, and Charles Brown, as I understand it, was assistant chief.

* * * * * * *

[fol. 26] RUSSELL HUSS, resumed.

Cross examination (Continued).

By Mr. Fink:

Q. Mr. Huss, you have stated that in connection with the Stevens arrangement, the price varied from time to time?

A. That is correct.

Q. I am not certain I recall whether you specified what the price was measured by. What was the price?

A. Well, the price was always determined by the quality, the quality of the coal and the market value of the coal after it had been put on the market.

As time went on, from 1944 to 1947, the coal price increased continuously.

Q. You sold the coal to Stevens who in turn sold it on the market. Is that the situation?

A. That was the situation. I believe—and I am not too positive, but I believe with the Philadelphia and Reading Coal and Iron that they act as a sales company for a portion of their coal.

Q. You did not get a stated price per ton of coal delivered in connection with the Stevens contract?

A. Oh, yes, I got a stated price delivered on a ton of coal.

Q. Was it agreed to before you delivered the coal?

A. Absolutely.

Q. It was agreed to before the market price was then known?

A. The market price was known at that time.

* * * * * * *

[fol. 31] Q. Now, sir, have you continued stripping for Philadelphia and Reading Coal and Iron after 1947?

[fol. 32] A. Yes.

Q. Down through when, sir?

A. Well, I think it is, if I am not mistaken, until February of '54.

Q. You used in that stripping some of the equipment that you had at the end of '47?

A. Well, what I used in that stripping was a new shovel I bought in '47.

Q. What did you do with the equipment at the end of 1947 that you had?

A. Some of it I moved on to other properties, and some of it I sold because I had no further use for it.

Q. Now, sir, did I understand your direct testimony to be you stopped stripping on these lands when you found it to be unprofitable?

A. When I found it to be unprofitable, then I had completed my contract.

Q. When you had completed your contract, isn't that so?

A. And it was unprofitable to go any further.

. . . . . .

Redirect examination.

By Mr. Berger:

Q. If the ratio was higher than 4-to-1 or 6-to-1, could you continue to recover coal?

A. You could if you wanted to if the price would warrant. It would depend entirely on the type of overburden you had to remove.

Q. Were there occasions when you did go beyond the 4-to-1 or 6-to-1 ratio?

A. Yes, I would say there was times that I went over the 4-to-1 or the 6-to-1, and the contracts were worded so it was an average over the property as near as anyone could —now, I wouldn't tell you how much over that I ever went.

. . . . . .

[fol. 33] Defendant's Evidence

Mr. Fink: Mr. Brown, please.

CHARLES E. BROWN, having been duly sworn, was examined and testified as follows:

Direct examination.

By Mr. Fink:

Q. What is your name?
A. Charles E. Brown.
Q. What is your business, Mr. Brown?
A. Mining engineer for the Philadelphia and Reading Coal and Iron Company.
Q. Where are you located for that company?
A. Pottsville, Pennsylvania.
Q. What were your duties with that company from 1944 through 1947?
A. Mining engineer.
Q. Are you in charge of their stripping contracts?
A. I am.
Q. You were in the court room today and heard Mr. Huss testify about a conversation with either you or another gentleman, Mr.——
A. Mulhoff.
Q. Concerning the termination clause contained in P-22, Contract P-22, which is Exhibit P-1 here.
A. (No response.)

The Court: Is that right? Did you hear that testimony?

By Mr. Fink:

Q. Did you hear that testimony?
A. I heard the testimony, yes.

* * * * * * *

[fol. 34] Q. Do you remember any conversations with Mr. Huss shortly prior to the negotiation and execution of P-22?
A. No doubt we talked over with Mr. Huss certain phases of the contract. I don't recall of any particular discussion of the cancellation contracts.

* * * * * * *

Cross examination.

By Mr. Berger:

Q. Now, Mr. Brown, you have testified that an economic study of the price and the—strike that.

You have testified that an economic study of the price was made by your company before these particular contracts were let?

A. That's right.

Q. That is correct, isn't it?

A. That is correct.

Q. And you were familiar with that economic study, weren't you?

A. Yes.

Q. This was brought to your attention even though you personally didn't make the study; isn't that correct?

A. That's right.

Q. And you considered that and took that into account when you negotiated the contracts here with Mr. Huss; isn't that right?

A. Yes, that's right.

• • • • • • •

Recross examination.

By Mr. Berger

Q. When you said that [illegible] have caused the termination of the contract, referring to the economic conditions, that was your opinion; is that right?

A. I am only expressing my opinion.

Q. You are not a lawyer, are you?

[fol. 35] A. I am not.

Q. You don't know the legal rights or duties of your company under the contract, do you?

A. Only as a layman.

Q. Only as a layman.

But are you familiar, sir, in your official capacity, with the fact that these contracts were never terminated unilaterally by the Philadelphia and Reading Coal and Iron Company?

A. That's right, I know that.

Q. And you are familiar also with the fact that when Mr. Huss and his brothers completed the stripping in accordance with their determination with respect to the economic situation that then there was a mutual cancellation agreement between the company and the Husses?

A. After they finished their contract according to the specifications, that's right.

* * * * * * *

[fol. 36]

EXCERPTS FROM PLAINTIFF'S EXHIBIT No. 1.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY
Pottsville, Pennsylvania

CONTRACT

FOR

STRIPPING AND MINING THE VARIOUS VEINS ON THE NORTH AND SOUTH DIPS AT THE TOWER CITY SECTION IN AREAS DESIGNATED BY THE COAL COMPANY'S ENGINEER-STRIPPING No. P-22B

* * * * * * *

ARTICLE 1.—DESC[illegible] OF PROJECT.

It is the understanding o[illegible] parties hereto that this project is a "salvage stripping" operation. CONTRACTOR agrees to assume all risk connected with the prospecting, discovery and recovery of all the coal that is recoverable by stripping in the areas designated by the COAL COMPANY'S ENGINEER.

CONTRACTOR does also hereby covenant, promise and agree, for the consideration hereinafter named, to do all work and provide all the material, labor, tools, equipment, water, light, power, transportation and other facilities unless specified otherwise hereinafter, required for the excavation, removal and disposal of all overburden material and divider slate lying over, between and/or in the veins of coal

and for mining, transporting, and delivery into the raw coal chute at Westwood Breaker of all the raw coal that is recoverable by stripping within the areas designated by COAL COMPANY'S ENGINEER and within the limits set forth by said COAL COMPANY'S ENGINEER, all the above to be done in accordance with the Contract Documents referred to herein and hereto attached, and under the direction and to the satisfaction of COAL COMPANY'S ENGINEER.

* * * * * * *

[fol. 37] ARTICLE 5.—DEFINITION OF TERMS.

* * * * * * *

The term "salvage stripping" as used herein shall be deemed to mean a project wherein COAL COMPANY reserves a coal-bearing area for CONTRACTOR, gives CONTRACTOR permission to enter upon this area and strip it, and agrees to pay CONTRACTOR a specified amount of money for each ton of raw coal that CONTRACTOR delivers to COAL COMPANY at a point and under certain conditions specified by COAL COMPANY. In a "salvage stripping" project COAL COMPANY assumes no responsibility for the discovery of coal, gives CONTRACTOR no guarantee of the quantity of coal in the stripping area and places upon CONTRACTOR all risk in connection with the prospecting, discovery and recovery of coal and the operation of the entire stripping project.

* * * * * * *

ARTICLE 9.—WORK TO BE DONE BY CONTRACTOR.

CONTRACTOR agrees to perform all work required for the prospecting, discovery and recovery of all coal; the removal of overburden; and for the delivery of raw coal into the Raw Coal Chute at Westwood Breaker located at Westwood Colliery and owned by COAL COMPANY; all the above to be done to the extent and under the conditions described in the Contract Documents.

ARTICLE 10.—ITEMS TO BE PROVIDED BY CONTRACTOR.

Unless otherwise stipulated, CONTRACTOR agrees to provide and pay for all materials, labor, tools, equipment,

water, light, power, transportation and other facilities necessary for the execution and completion of the work. Materials or work described in words which so applied have a well-known technical or trade meaning shall be held to refer to such recognized standards.

[fol. 38] ARTICLE 11.—DETERMINATION OF SCOPE OF WORK.

The term "Scope of Work" as used herein is understood by the parties hereto to refer to everything required to extract, process and deliver into the raw coal chute at Westwood Breaker, all of the raw coal that is recoverable by stripping within the areas of the project described in Articles 1 and 2.

* * * * * * *

ARTICLE 15.—REMOVAL AND DISPOSAL OF OVERBURDEN.

CONTRACTOR agrees to remove and dispose of overburden and divider slate as provided in the Specifications.

* * * * * * *

ARTICLE 19.—SCHEDULE OF EQUIPMENT.

CONTRACTOR agrees to have at least the following equipment on the job, with competent and sufficient foremen, operators, and laborers to operate same, and at work within the time specified after each item:—

Name, Type and Size of Equipment:	Equipment Will be at Work on the Job Within Number of Days Indicated Subsequent to Date of This Contract
Power Shovels, Drills, Trucks and Miscellaneous Equipment	
Sufficient power shovels, well drills, trucks, tractors, pumps and other miscellaneous equipment to properly execute the work on this project:	When required.

* * * * * * *

[fol. 39] ARTICLE 22.—SCHEDULE OF COAL EXTRACTION.

CONTRACTOR agrees, unless delayed by fires, strikes, floods or other unavoidable casualties, or by the written instructions of COAL COMPANY, to produce, and to maintain the stripping and mining operations in condition to produce the maximum number of gross tons of raw coal obtainable per single seven (7) hour shift, beginning at a reasonable time after the date of this contract and continuing thereafter to completion of the project.

After completing the removal of coal by dipper shovel, CONTRACTOR shall install drag shovel equipment to recover, to the satisfaction of COAL COMPANY'S ENGINEER, whatever coal that cannot be recovered by dipper shovel.

ARTICLE 23.—SUSPENSION OF WORK.

(a) CONTRACTOR covenants and agrees that COAL COMPANY shall have the right to entirely cancel and terminate this contract, without specifying any reason therefor, upon thirty (30) days' notice in writing to CONTRACTOR of COAL COMPANY'S intention so to do, and in that event COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or any other damages whatsoever.

(b) CONTRACTOR further covenants and agrees that COAL COMPANY shall have the right to temporarily suspend work under this contract at any time or times by giving CONTRACTOR written notice of COAL COMPANY'S intention so to do. Should any such temporary suspension be made and continue for a period of five (5) weeks, except in case of strike or lockout, CONTRACTOR may notify COAL COMPANY in writing of CONTRACTOR'S desire to cancel this contract and, if within thirty (30) days after receipt of said notice COAL COMPANY fails to give CONTRACTOR a written order to resume work, then CONTRACTOR may thereupon, by written notice served upon COAL COMPANY, forthwith cancel and terminate this contract. In the event of any such cancella-
[fol. 40] tion by CONTRACTOR, COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or other damages whatsoever. If no such notice to cancel this contract has been given by CONTRACTOR and COAL COMPANY

desires at any time a resumption of the work under this contract, it shall so notify CONTRACTOR, and upon receipt of such notice CONTRACTOR agrees that he will, within five (5) days thereafter, resume operation.

• • • • • • • • •

ARTICLE 37.—CONTRACT PRICE.

COAL COMPANY hereby agrees to pay to CONTRACTOR as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the price of one dollar and eighty-five cents ($1.85) per gross ton as determined by scale weight in trucks of CONTRACTOR at COAL COMPANY'S Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents.

• • • • • • • •

[fol. 42]

IN UNITED STATES DISTRICT COURT

OPINION SUR PLEADINGS AND PROOF—March 26, 1957

Van Dusen, J.

The trial judge makes the following Findings of Fact and Conclusions of Law:

I. FINDINGS OF FACT:

1. Plaintiffs, George Huss, Wesley Huss and Russell Huss, during the years 1944 to 1947, were members of a partnership engaged in the business of mining coal by the

strip mining method, with a principal place of business at Ringtown, Schuylkill County, Pa.

2. Pursuant to written agreements with the Philadelphia and Reading Coal & Iron Co. (hereinafter called "Reading"), denominated P-22, P-22B, P-29, P-32 and P-35, dated, respectively, May 27, 1944, February 23, 1945, May 8, 1945, December 17, 1945, and July 19, 1946 (plaintiffs' Exhibit 1 and Stipulation Exhibits A, B, D, & E), the plaintiffs, in the tax years 1944 to 1947, inclusive, strip mined coal on land owned by Reading in the Good Springs area known as the Tower City Tract, located in Schuylkill County, Pa.

3. Plaintiffs also entered into another strip mining contract with Reading, P-30, dated July 16, 1945, in the Minersville area, about 10 or 12 miles from the Tower City area (Exhibit C; N. T. 86, 87).

4. Further, plaintiffs had periodic oral strip mining arrangements with the Stevens Company (hereinafter called "Stevens") for about four or five different tracts during the years 1944 to 1947, inclusive).[1]

[fol. 43] 5. During these same years, plaintiffs also strip mined for the Jones Coal Company, Jack Jones, and the Peters Creek Coal Company.

6. Defendant Francis R. Smith was Collector of Internal Revenue for the First District of Pennsylvania from May 1, 1945, to November 11, 1952 (Stip. par. 1). All the federal income taxes paid by plaintiffs for the tax years

[1] These contracts on the basis of which plaintiffs claim percentage depletion deductions are those with Western Anthracite and not with Stevens Company. Part of the arrangement included that the coal be sold to Stevens, but the coal could have been sold to another coal company. The prospecting and uncovering of the coal was done by plaintiffs under contracts between Western and plaintiffs. Only when the coal was uncovered did plaintiffs enter into separate agreements with Stevens for the sale of such coal. But since counsel have referred to these coal contracts as the "Stevens" contracts, the court in this opinion will similarly do so, though recognizing that the initial agreements with Western Anthracite are the agreements upon which plaintiffs' claims for percentage depletion are based.

1945 to 1947, inclusive, were paid to the above-stated defendant.

Plaintiffs paid most of their federal income taxes for 1944 to the predecessor in office of the defendant Collector, but in 1946 plaintiffs each paid defendant Collector $987.56 as an additional payment on their 1944 income taxes. Plaintiffs' total payment of income taxes for the year 1944 are in amounts as large as the amounts they seek to recover (Stip. par. 4).

7. The partnership of which plaintiffs are members duly filed its income tax returns for the years 1944, 1945, 1946, and 1947, but in each of said returns of its income it failed to take credit for depletion in connection with the mining contracts aforesaid, and stated the distribution to the individual partners accordingly, with the result that the distributive income of each partner was, by said return, shown to be higher for income tax purposes than it would have been had the statutory percentage depletion been deducted in such statement and return.

8. Plaintiffs, in the years 1948 to 1950, inclusive, each filed claims for refund for the taxable periods 1944 to 1947, inclusive. On these claims, the defendant Collector of Internal Revenue allowed plaintiffs percentage depletion only as to the Jones Coal Company, Jack Jones and the Peters Creek Coal Company, making refunds of a portion of the amounts claimed for those years. To the extent that the claims for refund were not allowed, plaintiffs were denied percentage depletion with respect to the [fol. 44] Reading and Stevens contracts mentioned in paragraphs 2, 3, and 4 above. Statutory notices of such disallowance were sent to each of plaintiffs by registered mail on May 10, 1951 (N. T, 104 and Stip. par. 3).

9. Plaintiff George Huss claimed refunds of $9,861.54 for 1944, $7,189.38 for 1945, $5,728.46 for 1946, and $5,107.20 for 1947.

Plaintiff Russell Huss claimed refunds of $9,861.54 for 1944, $7,270.10 for 1945, $5,720.04 for 1946, and $5,089.91 for 1947.

Plaintiff Wesley Huss claimed refunds of $9,861.54 for 1944, $7,270.10 for 1945, $5,734.30 for 1946, and $5,146.92 for 1947.

The claims for refund of each plaintiff were allowed to the extent of $4,799.65, plus interest, for the year 1944; $1,847.57, plus interest, for the year 1945; and $646.54, plus interest, for the year 1947 (Stip. pars. 2 and 3).

10. Prior to signing the contract of May 27, 1944, (P-22) between plaintiffs and Reading, plaintiffs went onto the land, looked over the ground, and moved in equipment so as to test for the presence of sufficient coal to start the operation.

11. Before the five Tower City stripping contracts (see Finding No. 2) were let, Reading furnished plaintiffs with surface maps showing where the veins of coal were or where they were supposed to be. All of the tracts had been deep-mined and the tract covered by P-22B had been partially strip mined, but plaintiffs were the first to strip mine on the other four areas involved in the Reading contracts.

12. After P-22 was negotiated, plaintiffs never investigated by test boring or prospecting for coal before signing the other contracts. Plaintiffs could see where the land had been previously mined and the thickness of the exposed veins of coal. When the contracts after P-22 were [fol. 45] offered to plaintiffs, they were well acquainted with the tracts being offered and were able to discuss prices for delivery of the coal to the colliery. Except for changes in price due to increased labor costs, plaintiffs entered into all the contracts after P-22 without detailed negotiations of their terms.

13. Plaintiffs' job, in both the Reading and the Stevens contracts, consisted of removing the loose overburden from the top, drilling and shooting the rock overburden, removing this overburden by dragline, cleaning the coal, loading the coal on trucks, and delivering it to the Westwood colliery operated by Stevens. When the coal was delivered to the colliery, it was weighed in and, at the end of each day, plaintiffs got a sheet with the number of loads and the weight of the coal they had delivered.

14. Reading had the right to send inspectors on the property to direct plaintiffs as to the average amount of overburden to be removed in ratio to the coal, and they occasionally exercised that right. The inspector also checked the coal to see whether it was acceptable or not before it was loaded in trucks.

15. The coal from the Forestville area was delivered to the same colliery by railroad cars on the Reading Railroad. Plaintiffs' contract, P-30, called for loading the coal at a siding in Forestville, and, pursuant to a working agreement between Reading and Stevens, one of the latter two paid the freight from the loading point to the colliery.

16. In all of the Reading contracts, plaintiffs were paid a stated price per ton of coal delivered to the colliery (N. T. 33, 35, Article 37 of P-22).[2]

[fol. 46] 17. As to both the Reading and Stevens contracts, plaintiffs themselves determined when and where to begin and to stop the mining in a particular area. They also determined whether or not it would be profitable to begin strip mining. If plaintiffs had determined that it would not have been economically possible, they were not entitled to be reimbursed for their prospecting costs.

18. Plaintiffs paid the men who did the work in this operation and also paid for all of the equipment, supplies and materials.

19. In order to get the equipment to the first job site, plaintiffs spent $10,000. to $15,000. for building roads and moving. This figure, though, includes plaintiffs' labor and supply costs—i.e., the cost of their own employees. One shovel was moved 1½ miles and the other 3½ miles to this first Tower City tract. Both were moved by walking them

[2] Article 37 of all six Reading contracts provided that the price per gross ton was "full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work . . . ; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith. . . ."

on their own power. The other Tower City stripping areas were contiguous areas, adjacent to one another, and, except for some equipment purchased to put on those tracts, plaintiffs moved equipment from one tract to another. No equipment was permanently affixed to any of the tracts so as not to be feasibly removed. But none of the equipment could very well be used for purposes other than coal stripping except the bulldozers and trucks.

20. After the stripping of the Forestville tract, the equipment used there was moved to Tower City and, at the end of 1947, plaintiffs' equipment was either moved on to other properties or sold.

21. The equipment initially taken in for the first Tower City contract job in 1944, and not acquired solely for that contract, included two draglines (one 2½-yard and one 3½-yard dragline), bulldozers, drills, air compressors, a number of trucks, and about 15 large trucks and coal haulage trucks, the value of all which was "around $100,000." Other materials used in carrying out the strip mining con- [fol. 47] tracts were all sorts of parts and supplies, cables, fuel oil, motor oil, greases, gasolines, electricity, and parts for machinery. Also, plaintiffs had to construct buildings, shops and supply houses.[3] During the operations on the Tower City contracts, one 2-yard dragline was shifted to another operation. By the end of 1947, plaintiffs had "around $500,000. worth of equipment" on the job. But this same equipment had been used on other coal stripping contracts not with Reading, with the exception of the 3½-yard machine.

22. All of the equipment and supplies used in the contracts with Reading and Stevens were paid for by plaintiffs, but plaintiffs took deductions on their tax returns for all those items—i.e., the labor force and the equipment—as ordinary and necessary expenses of doing business. Also, plaintiffs got depreciation on the described equipment.

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[3] At least one court believes the expenses as outlined above are of doubtful relevance. See *Usibelli v. Commissioner of Internal Revenue*, 229 F. 2d 539, 543 (9th Cir. 1955).

23. About three weeks after entering onto P-22, plaintiffs were producing a small amount of tonnage, but it was at least two months before they got tonnage that would compensate them and give them a small profit. "Some coal" was produced off P-29 shortly after that contract was signed.

24. The Reading contracts required plaintiffs to strip mine coal as long as no more than a specified ratio of cubic yards of overburden per gross ton of raw coal recovered was present (N. T. 137-8, Article 2 of P-22). When the ratio, usually four or six cubic yards of overburden to one ton of coal, ran higher than that specified in the contracts, it would usually be unprofitable to strip mine coal, and plaintiffs were not required to do so. Plaintiffs could continue to strip mine at ratios higher than that specified in the contract if they thought the price warranted their so doing.[4]

[fol. 48] 25. The contract price arrived at in the Reading contracts were arrived at after considering, among other things, the amount of overburden that was to be removed to obtain one ton of coal, the possibility of recoverable coal in the tract, and the length of the haul from the tract to the point of delivery.[5]

26. The negotiations between plaintiffs and Reading for the price of the work to be performed were originally conducted on behalf of Reading by the company's engineer in charge of coal stripping in the area. In determining whether to recommend acceptance of the price to the company, the company engineer had available an economic study prepared by another department of the company, which appraised the future market price of coal. His recommendation to Reading was based upon the fixed costs, his estimate, or the estimate furnished to him, of the future market price of coal, and a figure designed to insure a reasonable margin of profit.

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[4] There were occasions when plaintiffs did continue to strip mine beyond the stated ratio, but generally it was unprofitable to do so.

[5] There is no evidence that plaintiffs, in bargaining for a contract price, contemplated that they would have the depletion tax deduction.

27. The contracts provided for an increase or decrease in the price per ton of coal corresponding to a change in labor costs[6] (Article 38 of P-22, N. T. 38).

28. Except when labor prices changed, plaintiffs were paid the same price per ton of coal delivered whether or not Reading sold it or whatever price Reading obtained on the market. If Reading could not sell the coal or the market price fell, Reading still had to pay plaintiffs the contract price unless they closed the job down (N. T. 103, 109, 110, 156-7; see paragraph 30 below). There was [fol. 49] no change in the contract price because of a change in the market.

29. The coal did not belong to plaintiffs. If Reading rejected the delivered coal, plaintiffs had no right to sell the coal without Reading's agreement. If Reading agreed, then plaintiffs could negotiate the sale of the coal to another colliery. Reading would then collect the purchase price from the buyer and pay plaintiffs the contract price per ton.

30. Reading, in its discretion, could entirely cancel and terminate the contracts prior to the completion of the stripping by giving thirty days' written notice to plaintiffs of its intention to do so (Article 23 in all of the Reading contracts).[7]

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[6] The two supplemental agreements to P-22 of August 20, 1945, and October 28, 1946, respectively raised the price from $1.75 to $1.85 and then to $2.00 (N. T. 35-9 and Exhibit P-1). Increases in wage payments and wage scales obtained by the United Mine Workers in a new United Mine Workers agreement resulted in a rise in the price of coal on the open market within the next three to six months following such increases.

[7] Each of the Reading contracts, except P-22, contained the following language:

> "CONTRACTOR covenants and agrees that COAL COMPANY shall have the right to entirely cancel and terminate this contract, without specifying any reason therefor, upon thirty (30) days' notice in writing to CONTRACTOR of COAL COMPANY's intention so to do, and in that event COAL COMPANY shall not be liable

[fol. 50] 31. No particular duration of time was specified in the agreements with Reading or Stevens and plaintiffs continued to strip mine under the contracts until they reached the stipulated ratios embodied in the contracts and it was no longer profitable to continue stripping. Plaintiffs then had completed their contracts and such contracts were cancelled by mutual agreement. Neither Reading nor Stevens ever unilaterally terminated or suspended operations on any of the contracts.

32. The four or five tracts concerning which the Stevens agreements were made also are in the Good Springs area. In 1944, Stevens had an operating agreement with the owners of the land, the County Commissioners of Schuylkill County, paying them for the right to extract from the land any coal that they located. On or before December

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to CONTRACTOR for any loss of anticipated profits or any other damages whatsoever."

Contract P-22 contained this clause:

"(b) CONTRACTOR further covenants and agrees that COAL COMPANY shall have the right to temporarily suspend work under this contract at any time or times by giving CONTRACTOR written notice of COAL COMPANY's intention so to do. Should any such temporary suspension be made and continue for a period of five (5) weeks, except in case of strike or lockout, CONTRACTOR may notify COAL COMPANY in writing of CONTRACTOR's desire to cancel this contract and, if within thirty (30) days after receipt of said notice COAL COMPANY fails to give CONTRACTOR a written order to resume work, then CONTRACTOR may thereupon, by written notice served upon COAL COMPANY, forthwith cancel and terminate this contract. In the event of any such cancellation by CONTRACTOR COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or other damages whatsoever. If no such notice to cancel this contract has been given by CONTRACTOR and COAL COMPANY desires at any time a resumption of the work under this contract, it shall so notify CONTRACTOR, and upon receipt of such notice CONTRACTOR agrees that he will, within five (5) days thereafter, resume operation."

Clause (a) of Article 23 required 30 days' written notice if the contract was to be cancelled after the contractor had completed stripping within the area and limits covered by that contract, but no such 30 days' written notice was required if cancellation was made at any time under clause (b), as quoted above.

31, 1944,[8] Western Anthracite (whose office is at Pottsville) contracted with the County Commissioners and got control of this land.

33. On or before December 31, 1944, plaintiff Russell Huss made an oral agreement for plaintiffs with Anthony Mosseline, of Western Anthracite (hereinafter called "Western"), permitting plaintiffs to go on the land and prospect for coal in return for a stated royalty per ton. If plaintiffs found and uncovered coal, Western could never refuse to let plaintiffs take such coal off the land and sell the coal to whomever they wanted, providing they would pay Western all of their royalties. Thus, as soon as plaintiffs uncovered a vein of coal, a binding obligation was in force between them and Western.

[fol. 51] 34. There was also a working agreement between plaintiffs and Stevens[9] whereby plaintiffs, having the privilege of going on the land from Western, would find a vein of coal and show a sample of it to Joseph Jones of Stevens. A price would then be negotiated between plaintiffs and Stevens. Plaintiffs would deliver the coal to the Westwood colliery and Stevens would pay plaintiffs the agreed upon price and also pay Western the royalty obligation that plaintiffs had to the latter.[10]

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[8] Plaintiff Russell Huss' testimony as to when Western Anthracite contracted with the County Commissioners for control of the lands is admittedly vague as to dates, since he "wasn't concerned about it at the time." He testified that in 1944 someone else could have gone on those lands and extracted coal that they located merely by making arrangements with the County Commissioners, but that in later years the land was controlled by Western Anthracite. At another point in the testimony, he added that he believed the agreement between Western Anthracite and the Commissioners was before "sometime in 1944." He also testified that he made one agreement with Stevens in 1944, and that the others were in 1945, 1946, and 1947. There is no evidence when in 1944 such an agreement was made.

[9] This agreement was made by Russell Huss and Joseph Jones, colliery superintendent of the Westwood colliery.

[10] On some occasions, though, plaintiffs paid a royalty directly to Western. If plaintiffs had sold to someone other than Stevens, then they paid the royalty directly to Western.

35. These individual agreements between plaintiffs and Stevens for the coal from the particular vein contemplated a stated price per ton delivered to the colliery. The stated price per ton was determined after considering such factors as the market value of the coal at the time of the agreement,[11] the quality of the coal, and the length of the haul to the colliery. This agreed upon price was subject to renegotiation at any time.

36. Plaintiffs were not obligated to sell and Stevens was not obligated to buy. At any time Stevens could stop taking coal at the agreed price. If Stevens refused to take the coal, plaintiffs had the right to sell it on the open market. But plaintiffs always sold their coal taken from Western lands to Stevens.

37. Paragraphs 7 (first sentence only, substituting the word "these" for the word "all" and deleting the words "but not limited to" and "quality."), 8,[12] 9 (amended to specify that the testimony did not make clear whether [fol. 52] the Reading or Stevens contracts or both were involved), and 10 requested by plaintiffs are correct but are found by the court to be of slight or no relevancy.

All plaintiffs' requests for Findings of Fact which are inconsistent with the foregoing are denied.

II. Discussion.

Treasury Regulation 111, § 29.23(m)-1, promulgated under the Internal Revenue Code of 1939, outlines the following standard in determining who is entitled to take the percentage depletion deduction for strip mining coal under §§ 23(m) and 114(b) of the Internal Revenue Code of 1939 (26 U. S. C. A. § 23(m) and § 114(b)(4)):

> "The owner of an economic interest in mineral deposits or standing timber is allowed annual depletion

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[11] This market price was necessarily affected by O. P. A. rulings during the period prior to 1947, since increases could only be secured by application to the Government.

[12] In view of the fact that these contracts could be terminated on 30 days' written notice, the provision reserving the area for plaintiffs is of very little, if any, relevance.

> deductions . . . An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in minerals in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital."[13]

The Supreme Court has stated in *Burton-Sutton Oil Co. v. Commissioner of Int. Rev.*, 328 U. S. 25, 34-5 (1946), an oil depletion case, that "It is the lessor's, lessee's or transferee's 'possibility of profit' from the use of his rights over production, 'dependent solely upon the extraction and sale of the oil,' which marks an economic interest in the oil . . . ," not the title to the mineral in place. "As the oil is extracted and sold, that economic interest in the oil [fol. 53] in place is reduced and the holder or owner of the interest is entitled to his equitable proportion of the depletion as rent or royalty."

The Court of Appeals for the Third Circuit has recently considered this problem in *Commissioner of Internal Rev. v. Mammoth Coal Co.*, 229 F. 2d 535, 537 (3rd Cir. 1955), rehearing denied 229 F. 2d 539 (3rd Cir. 1956), and noted that "there is no general rule that a strip miner is or is not entitled to percentage depletion." What constitutes an economic interest will be determined by "the facts in each case."

Plaintiffs are not entitled to percentage depletion on amounts received under the Reading contracts based on these principles for the following reasons:

A. *The right of plaintiff to strip mine was terminable on thirty days' notice at the will of the owner of the coal lands.*

Under the agreement in the *Mammoth case, supra,* the court said at page 538:

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[13] The regulation continued to state that:

". . . a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production."

"The stripper had the exclusive right to mine coal in the areas embraced by the agreement. This exclusive right was not limited in time but was to continue indefinitely. The (Coal Co.) did have the right to call for a suspension of mining operations, and in such event under certain conditions regarding time and notice the stripper was free to give up the mining operation, but this was his own choice and unless he voluntarily did so, the (Coal Co.), though calling for a suspension of operations, could not permit anyone else to mine the area. Thus, for all practical purposes, the stripper had the exclusive right to mine the area to exhaustion."

On rehearing to consider the coal company's contention in the *Mammoth Coal Co. case* that "the contractor's rights [fol. 54] were at all times terminable by the (Coal Co.)," the court found this not to be true,[14] and stated at page 539:

". . . Usibelli v. Commissioner of Internal Revenue, 9 Cir., 229 F. 2d 539, relied on by the taxpayer, is in complete accord with the disposition which we made in the opinion filed by the Court in this case on November 30, 1955. In Usibelli the Court pointed out that the contract there was terminable at the will of the taxpayer mine owner."[15]

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[14] In the per curiam opinion on the petition for rehearing, the court found that the contract in question "was not terminable at will but only for cause, i.e., bankruptcy or default by (the coal company)." *Commissioner of Internal Rev. v. Mammoth Coal Co.*, 229 F. 2d 535, 539 (3rd Cir. 1956).

[15] In the *Usibelli* case, *supra*, the Ninth Circuit found that a coal stripper on land of the United States, under yearly contracts with the Army to mine specified tonnages for specified sums, was not entitled to depletion deduction for income tax purposes. On page 546 of its opinion, the court found that "the government could in its discretion terminate the contract. (The stripper) had no control over the production output of the mines being limited to the production of a specified amount of coal. . . . The coal came from (the United States') lands and was used by it. (The stripper) took no title to it and accordingly (the stripper's) contention that the coal was sold to the Army is untenable. . . . (The stripper's) gain depended, not as is contended by him upon the severance and

In the Reading contracts in this case, while it appears that the stripper had an exclusive right to mine coal in the areas embraced by the agreements,[16] such right was not to continue indefinitely. Plaintiffs have failed to sustain their burden in proving an oral variation of the terms of Article 23 (the Suspension of Work-clause) in the written contracts[17] and at any time, with proper notice, Reading

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sale of the coal but upon the covenant of the United States Government to pay him a certain sum for services performed. This sum was in no way affected by fluctuation of market price."

[16] See plaintiffs' request for Finding of Fact 8, Finding of Fact 37, and footnote 12.

[17] Plaintiff Russell Huss testified that he and George Huss, a week or two before they signed P-22, the first of the Reading contracts, had a conversation with Charlie Brown and Bill Mulhoff, of the Reading engineering department, at the Reading offices in Pottsville, concerning the cancellation clause in that contract. Plaintiff testified that they inquired whether, if they moved in on the property, spending $10,000. to $30,000. doing so, could Reading cancel out at any time with a 30-day notice, and that they were told that the "provision was put in there in a form contract so as if they got hold of a contractor who was not reputable, who didn't live up to the contract, they could put him off the property without court action."

Charlie Brown, a disinterested party to these proceedings, then took the stand and testified that he didn't recall any particular talk on the cancellation clause of the P-22 contract nor did he have any authority from Reading to alter the terms of their written contracts. Mr. Brown also testified that the operations here in question would not have been continued unless economically feasible. Further, in his opinion, Reading could have terminated the contract if its estimate of the future market price of the coal turned out to be a faulty estimate. But if the margin of profit became narrower, Reading would not necessarily have terminated the contract, but might have gambled on the length of the period.

Further, Article 13 of the Reading contracts provides as follows:

> "No amendment to this contract shall be valid unless the same is made by an instrument in writing executed by COAL COMPANY and by CONTRACTOR, and in case of such amendment, so much of this contract as is not necessarily thereby changed shall remain in force; and no act or conduct of either party shall be held to operate as a waiver of any provision of this contract, unless in writing duly executed by the party against which it is asserted."

[fol. 55] had the right to entirely cancel and terminate the contracts.

B. *Plaintiffs had a right to receive a fixed price per ton, irrespective of the market price.*

In the *Mammoth case*, the court said at page 538:

> "Although all extracted material was to be delivered to the (Coal Co.), the (Coal Co.) specifically reserved the right to reject any and all coal or coal material delivered to it, and thereupon the stripper would be free to sell the rejected coal to anyone it pleased for its own account."

The Third Circuit Court, in awarding percentage depletion deduction to the stripper, reasoned that when the stripper removed coal from the ground, "the (Coal Co.) was entitled to receive it. But the (Coal Co.) was not obligated to take it. If it chose not to, it owed the stripper nothing, and the stripper would be free to sell the coal to anyone at whatever price it could get."

With these factors in mind, the court concluded, also on page 538, that:

> [fol. 56] "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the (Coal Co.) should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

On the other hand, the situation presented in the Reading contracts is one where plaintiffs were always required to sell the strip mined coal to Reading in return for a stated price per ton delivered to the colliery, such price being adjustable only to reflect the increase or decrease in plaintiffs' labor costs, but not any changes in the market price. If Reading rejected the coal, plaintiffs needed Reading's agreement to sell the coal to another colliery, and even then Reading collected the purchase price from the buyer and paid to plaintiffs the standard contract price per ton.

C. *The coal remained an asset of Reading, rather than of plaintiffs.*

The basic theory involved is "that the deduction be allowed to the owner of wasting assets as compensation for that part of his assets which are used up in production." *Usibelli v. Commissioner of Internal Revenue*, 229 F. 2d 539, 542 (9th Cir. 1955).[18] In *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599, 603 (1946), the court stated the rule as follows:

> "'The test of the right to depletion is whether the taxpayer has a capital investment in the oil in place which is necessarily reduced as the oil is extracted. See An-
> [fol. 57] derson v. Helvering, 310 U. S. 404, 407, 60 S. Ct. 952, 954, 84 L. Ed. 1277.'"

Also, in *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308, 312 (1956), depletion was found to be "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." [19]

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[18] In addition, the Ninth Circuit stated, at page 541, that "the depletion deduction . . . is not to be construed . . . as a reward to those persons who actually mine the coal for the risks inherent in extraction. In common with industry generally those engaged in extraction of minerals on a for-hire basis receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working." It is noted that plaintiffs here have received a tax benefit through depreciation deductions on their tax returns (see Finding of Fact No. 22).

[19] In the *Southwest Expl. Co.* case, *supra*, at pp. 315 and 316, a drilling company which contracted to develop oil deposits lying offshore was denied the statutory depletion allowance available to the adjacent upland owner, since "permission to use the upland sites was the express condition precedent to the State's consideration of Southwest's bid," and "proximity to the offshore oil deposits and effect of the state law combined to make the upland owners essential parties to any drilling operations." The upland owners had the requisite economic interest since they "might have realized this value by selling their interest for a stated sum and no problem of depletion would have been presented. . . ." Their "contribution was an investment in the oil in place sufficient to establish their economic interest."

While the test for determining the presence of an economic interest in the mineral in place is not governed by ownership of the land, it is apparent that plaintiffs have not shown that they looked to the severance and sale of the mineral on the open market for their compensation. Instead, it appears that plaintiffs' compensation was directly dependent upon their personal covenants with Reading. The latter did not entitle plaintiffs to a depletion allowance. They, therefore, are not entitled to share in the benefits of a statute which was designed to give compensation to persons interested in the depletion of a wasting asset.

In conclusion, the Reading contracts contemplated: (a) the ability of Reading to terminate the contract at will upon thirty days' notice; (b) a stated price due plaintiffs notwithstanding any fluctuation in the market price; (c) plaintiffs' inability to sell the coal to another colliery on their own initiative; and (d) plaintiffs' not obtaining any separate interest in the coal itself other than that stated in the contractual agreements.

[fol. 58] These factors give the plaintiffs an economic advantage, rather than an economic interest, in the coal in place, and do not entitle them to a percentage depletion deduction.[20]

[fol. 59] The oral agreements comprising the "Stevens contracts," though, are factually very different from the

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[20] Plaintiffs rely upon the liberal view taken by the Fourth Circuit as to when a stripper acquires an economic interest, but all of the cases they cite are clearly distinguishable from the facts before this court.

In *Com. v. Hamill Coal Corp.*, 57-1 U. S. T. C. (CCH) Par. 9259 (4th Cir. 1956), the contract between the stripper and the lessee-coal company contemplated that the stripper's return was to be dependent upon market conditions. The court, at page 56,282, stated that:

". . . the contract specifically provided that the obligation of the taxpayer (lessee-coal company) to pay for the extraction of 16,000 tons of coal per month was dependent upon market conditions, the taxpayer agreeing on its part to give the coal mined by Daniel (coal stripper) the preference in making sales. Thus the parties themselves recognized that the success of the venture and the return to them of their respective

[fol. 60] Reading contracts. Subject to plaintiffs' paying royalties to Western, once they found and uncovered coal, they could remove the coal and sell it to anyone. By the con-

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investments depended upon the taxpayer's ability to make advantageous sales of the product."

Further, the coal stripper there had the duty to furnish at least 16,000 tons of coal per month if the market conditions permitted. Also, annual gross receipts of the strip miner exceeded $500,000. As opposed to this, there is no evidence in the record in this case as to how much coal was available at the minimum acceptable stripping ratio nor the gross receipts from either the Reading or the Stevens contracts. Also, the only statement in the Reading contracts which involved any definite production obligation was Article 22 of the contracts, under which plaintiffs agreed "to produce, and to maintain the stripping and mining operations in condition to produce, the maximum number of gross tons of raw coal obtainable per single seven (7) hour shift, beginning at a reasonable time after the date of this contract and continuing thereafter to completion of the project." But there was nowhere a showing that plaintiffs had to have more than one man on each seven-hour shift. Further, there is no evidence of the gross receipts of the partnership from either the Reading contract or th. (sic) Stevens contract.

The following conclusion of the Fourth Circuit on the above facts, at page 56,283, is, therefore, not inconsistent with the result reached here:

> "In our opinion these conditions created an economic interest in the mineral in place not only in the taxpayer but also in Daniel, both of whom made a substantial investment and took a substantial risk dependent upon the successful sale of the coal."

In contrast to the *Hamill* case, in this case plaintiffs were assured of receiving the stated price per ton of coal produced and the above stated factors were not present. Also, if Reading could not buy the coal, plaintiffs could sell to another and still receive the stated contract price.

Similarly, *Weirton Ice & Coal Sup. Co. v. Commissioner of Int. Rev.*, 231 F. 2d 531 (4th Cir. 1956), cited by plaintiffs, is distinguishable from the facts of our case. In the *Weirton* case, the stripper, who had owned the coal lands, conveyed them at cost to a steel company under an agreement whereby the stripper was to have the exclusive right to mine coal and the land was to be reconveyed to the stripper when the coal was exhausted. Though many of the other provisions of the arrangement were similar to those in the Reading contracts, the conveyance at cost and the contem-

tracts with Stevens, the coal was delivered to the Westwood colliery in return for a stated price per ton, but Stevens was not obligated to buy nor were plaintiffs obligated to sell. At

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plated reconveyance clearly entitled the strippers to their percentage depletion.

In the case of *Commissioner of Internal Rev. v. Gregory Run Coal Co.*, 212 F. 2d 52 (4th Cir. 1954), cited in *Commissioner of Internal Rev. v. Mammoth Coal Co., supra*, at p. 539, as having reached a correct result on the fact situation before it, the coal stripping contracts were very different from the Reading contracts in this case, as indicated under A and B below:

A. As to coal stripping being done by the Swaney Contracting Company and Swaney, Inc. for the lessor of the land, Vincent:

1. At pages 56 and 59 the court recognized that in the arrangements with both Swaney companies "provision was made for adjustment of the compensation in the event of changes in the sales price of the coal." The court also recognized, at page 56, that the stripper, Swaney Contracting Co., "was to be paid for its services on the basis of the coal accepted and paid for by . . . the sales agent of (the coal company)." A similar arrangement existed as to Swaney, Inc. As to Swaney Contracting Co., "the contract was not cancellable except on specified defaults by the parties or in the event that the sales price on the coal fell below $2.76 per ton." As to Swaney, Inc., the lessor, Vincent, could cancel the contract only "if the price of the coal fell to a point where the operations were profitable to him."

2. Further, also at page 59, the court noted that the Swaney companies were to "haul a large tonnage per month and the production was to be continuous and as uniform as possible." Swaney Contracting Co. alone was required to mine and haul "25,000 tons of coal a month" (page 55). See the discussion above in this footnote that plaintiffs in the Reading contracts were not under a similar obligation.

B. In respect to the coal stripping being done by the Summit Fuel Company for the lessee, Gregory Run Coal Company, there was, similarly, a very different factual situation from that present in the Reading contracts:

1. The Gregory Run Company was owned equally by Vincent (the lessor of the land, to the Gregory Run Co.) and a Mr. Williamson. These same parties also each held one-half of the stock in the Summit Fuel Company. Thus, both the lessee and the stripper were owned by the same

any time plaintiffs or Stevens could have discontinued the arrangement and plaintiffs' investments would have been subject to the price of coal on the open market. Further, plaintiffs alone could at any time have stopped strip mining if it was not, in their opinions, profitable to continue.

While plaintiffs, in both the Reading and Stevens contracts, continued to strip mine until no longer profitable and then mutually agreed with the coal company to cancel the contract, only in the Stevens arrangements did they have the undisputed right to continue strip mining after coal had been uncovered. As distinguishable from the Reading contracts, in the Stevens arrangements the stripper, instead of looking merely to a contractual arrangement, had to look to the coal which it mined for return of its investment and profit.[21]

Although it is a close case, the economic interest which the strippers acquired in the Stevens contracts was sufficiently significant to entitle them to percentage depletion.

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persons. The court characterized the arrangement between them on page 55, footnote 2, as a "joint adventure."

2. Further on in the same footnote, the court stated that "either party had the right to cancel the agreement except that in case Gregory served notice of cancellation, then Summit should have the right to mine and remove all the coal which had been uncovered at that time." This clearly gave the stripper distinct rights over the coal in place immediately upon uncovering it.

Even where the views of the Fourth Circuit, as stated in the above three cases, to be at variance with those herein expressed, this court is bound by the views of the Court of Appeals for the Third Circuit.

See, also, *The Virginia B. Coal Company v. Commissioner*, CCH Dec. 21,545; 25 T. C. No. 102, page 2140 (Tax Court 1956), where the coal stripper was held entitled to a depletion allowance because the method for computing the amount which the strippers were to be paid clearly indicated that their possibility of profit and, hence, the recovery of their investment, was dependent to a large extent upon the sale of the coal.

[21] From the Stevens contracts it is clear that plaintiffs did acquire an economic interest in the coal in place immediately upon uncovering the coal. From that point on, they acquired such an interest as met the various tests described in C above.

III. Conclusions of Law

1. This court has jurisdiction over the parties and the subject matter.

2. Plaintiffs, in strip mining under P-22, P-22B, P-29, P-30, P-32 and P-35 for the Philadelphia & Reading Coal & Iron Co., in the tax years 1944 to 1947, inclusive, did not acquire an economic interest in the coal in place, entitling them to the depletion allowance on their gross income [fol. 61] derived therefrom, pursuant to Sections 23(m) and 114(b) of the Internal Revenue Code of 1939.

3. Plaintiffs, in strip mining under oral contracts with the Stevens Company in the tax years 1945 to 1947, inclusive, did acquire an economic interest in the coal in place, entitling them to the depletion allowance on their gross income derived therefrom, pursuant to Sections 23(m) and 114(b) of the Internal Revenue Code of 1939.

4. Plaintiffs have not sustained their burden to prove any definite arrangement of the type outlined in Findings of Fact Nos. 32 to 36 with Stevens or Western for strip mining coal prior to December 31, 1944,[22] and, hence, are not entitled to the depletion allowance under Sections 23(m) and 114(b) of the Internal Revenue Code of 1939 on their 1944 gross income from the Stevens contracts.

5. Plaintiffs' motion filed January 11, 1957, for leave to amend the caption of the complaint to include the United States of America as a party defendant has become moot in view of Findings of Fact Nos. 32 and 33 and Conclusion of Law No. 4.[23]

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[22] The date that Western got control of the involved lands was not established further than "sometime in 1944," and the contradiction exists that in that same year someone else could have made an agreement directly with the County Commissioners and gone upon the land and extracted the coal. Plaintiffs have not sustained the burden of proving the exclusive right to mine the coal they prospected at the time of the alleged one agreement in 1944 with Stevens.

[23] This ruling whether the court has jurisdiction to permit this amendment (since the claims for refunds on which these actions are based were all disallowed by the Commissioner of Internal

[fol. 62] 6. 33 P. S. 1 has no application to the Stevens contracts.[24]

The parties shall, within thirty (30) days of the date of the filing of these Findings of Fact and Conclusions of Law, submit their determination as to the amount of refund due plaintiffs in conformance with the above opinion.

/s/ Francis L. Van Dusen, *J.*

Revenue more than two years ago (Stip. par. 3 and Finding of Fact No. 8)), is unnecessary unless an appellate court modifies such Findings and Conclusion. For a consideration of the merits of this issue, compare Section 3772(a)(2) of the 1939 Internal Revenue Code; *Third Nat. Bank & Trust Co. v. White*, 58 F. 2d 411 (D. Mass. 1932); *Philadelphia H. & P. R. Co. v. Lederer*, 242 Fed. 492 (3rd Cir. 1917); and *Toledo Rys. & Light Co. v. McMaken*, 17 F. Supp. 338 (N. D. Ohio 1936), with Section 3770(b) of the 1939 Internal Revenue Code; 28 U. S. C. A. §§ 1346(a) and 2006; F. R. Civ. P. 15(c) and 21; *Moore Ice Cream Co. v. Rose*, 289 U. S. 373, 380-4 (1933); *Hammond-Knowlton v. United States*, 121 F. 2d 192 (2nd Cir. 1941); *Lamar v. Granger*, 99 F. Supp. 17, 45 (W. D. Pa. 1951); and *United States v. Koike*, 164 F. 2d 155 (9th Cir. 1947). Cf. *Ferd Mulhens, Inc. v. Higgins*, 55 F. Supp. 42, 44 (S. D. N. Y. 1943), and *Rogan v. Delaney*, 110 F. 2d 336 (9th Cir. 1940).

[24] The Statute of Frauds is inapplicable on the facts of this case for any one of the following reasons: (A) The Statute of Frauds cannot be raised by third parties where there is no privity of contract. Restatement of Contracts, § 218; 2 Williston on Contracts, § 530 (Rev. Ed. 1936). See *Burkhart v. Insurance Co.*, 11 Pa. Super. 280, 290-1 (1899); *Berenato v. Gazzara*, 346 Pa. 568 (1943); and *Dietrich v. KDT Coal Co.*, 61 Dauph. 304 (Pa. C. P.). See, also, *Smoot v. Commissioner*, 25 B. T. A. 1038 (1932). (B) Expenditure of money on the faith of the parol agreements makes for a binding contract giving absolute rights. *Cole v. Ellwood Power Co.*, 216 Pa. 283, 289 (1907); *Klingensmith v. Klingensmith*, 375 Pa. 178, 181 (1953); and *Haskell v. Heathcote*, 363 Pa. 184 (1949). (C) The Statute of Frauds does not apply to agreements which have been completely executed and performed on both sides. *Gerlock v. Gabel*, 380 Pa. 471, 476 (1955); *Edwards v. Glaske*, 165 Pa. Super. 108 (1949); *Leap v. Leahey*, 67 Pa. Super. 337 (1917); and *Sferra v. Urling*, 328 Pa. 161 (1937). (D) Each of the oral agreements could have been performed within "the term of three years from the making thereof." See *Bentz v. Barclay*, 294 Pa. 300 (1928).

[fol. 64]

IN UNITED STATES DISTRICT COURT

ORDER FOR JUDGMENT AND CERTIFICATE OF PROBABLE CAUSE—May 28, 1957

(In Appeal No. 12,315—Civil Action No. 14,775.)

Whereas, the above-entitled case came on regularly for trial before the Court sitting without a jury, with the parties appearing by their respective attorneys, and whereas the Court having heard the evidence adduced and having considered the briefs and arguments of the parties did, on March 26, 1957, enter its findings of fact and conclusions of law in favor of the defendant for the tax years 1944 and 1945 and partly in favor of plaintiff and partly in favor of the defendant for the tax years 1946 and 1947, it is hereby

Ordered, Adjudged and Decreed

that judgment be, and the same is hereby, entered in favor of the defendant and against plaintiff for the years 1944 and 1945 and entered in favor of plaintiff and against defendant for the sum of $625.77 for the year 1946, plus interest thereon from March 15, 1947, as allowed by law, and for the sum of $1,134.66 for the year 1947, plus interest thereon from March 2, 1948, as allowed by law, each party bearing his own costs.

[fol. 65] The Court further finds that the defendant, as Collector of Internal Revenue, acted under the direction of the Commissioner of Internal Revenue and upon probable cause in the collection of the taxes involved for the years 1946 and 1947 and that a certificate of probable cause should, therefore, be granted.

It is, therefore, ordered that a certificate of probable cause be, and the same is hereby, issued and entered in the above-entitled cause and that the defendant is hereby ordered relieved from the payment of this judgment and said judgment is ordered paid out of the proper appropriation from the United States Treasury.

/s/ Francis L. Van Dusen, United States District Judge.

....., 1957.

Approved as to Form only, G. Clinton Fogwell, Jr., United States Attorney, Alan J. Swotes, Assistant United States Attorney, Leon H. Kline, Attorney for Plaintiffs.

IN THE UNITED STATES DISTRICT COURT

ORDER FOR JUDGMENT AND CERTIFICATE OF PROBABLE CAUSE—May 28, 1957

(In Appeal No. 12,317—Civil Action No. 14,776.)

Whereas, the above-entitled case came on regularly for trial before the Court sitting without a jury, with the parties appearing by their respective attorneys, and whereas the Court having heard the evidence adduced and having considered the briefs and arguments of the parties did, on March 26, 1957, enter its findings of fact and conclusions [fol. 66] of law in favor of the defendant for the tax years 1944 and 1945 and partly in favor of plaintiff and partly in favor of the defendant for the tax years 1946 and 1947, it is hereby

Ordered, Adjudged and Decreed

that judgment be, and the same is hereby, entered in favor of the defendant and against plaintiff for the years 1944 and 1945 and entered in favor of plaintiff and against defendant for the sum of $624.93 for the year 1946, plus interest thereon from March 15, 1947, as allowed by law, and for the sum of $1,134.67 for the year 1947, plus interest thereon from March 2, 1948, as allowed by law; each party bearing his own costs.

The Court further finds that the defendant, as Collector of Internal Revenue, acted under the direction of the Commissioner of Internal Revenue and upon probable cause in the collection of the taxes involved for the years 1946 and 1947 and that a certificate of probable cause should, therefore, be granted.

It is, therefore, ordered that a certificate of probable cause be, and the same is hereby, issued and entered in the above-entitled cause and that the defendant is hereby ordered relieved from the payment of this judgment and said judgment is ordered paid out of the proper appropriation from the United States Treasury.

/s/ Francis L. Van Dusen, United States District Judge.

....., 1957.

Approved as to Form only, G. Clinton Fogwell, Jr., United States Attorney, Alan J. Swotes, Assistant United States Attorney, Leon H. Kline, Attorney for Plaintiffs.

[fol. 67]

IN THE UNITED STATES DISTRICT COURT

ORDER FOR JUDGMENT AND CERTIFICATE OF PROBABLE CAUSE—May 28, 1957

(In Appeal No. 12,319—Civil Action No. 14,777.)

Whereas, the above-entitled case came on regularly for trial before the Court sitting without a jury, with the parties appearing by their respective attorneys, and whereas the Court having heard the evidence adduced and having considered the briefs and arguments of the parties did, on March 26, 1957, enter its findings of fact and conclusions of law in favor of the defendant for the tax years 1944 and 1945 and partly in favor of plaintiff and partly in favor of the defendant for the tax years 1946 and 1947, it is hereby

Ordered, Adjudged and Decreed

that judgment be, and the same is hereby, entered in favor of the defendant and against plaintiff for the years 1944 and 1945 and entered in favor of plaintiff and against defendant for the sum of $625.78 for the year 1946, plus interest thereon from March 15, 1947, as allowed by law, and for the sum of $1,134.67 for the year 1947, plus interest thereon from March 2, 1948, as allowed by law, each party bearing his own costs.

The Court further finds that the defendant, as Collector of Internal Revenue, acted under the direction of the Commissioner of Internal Revenue and upon probable cause in the collection of the taxes involved for the years 1946 and 1947 and that a certificate of probable cause should, therefore, be granted.

It is, therefore, ordered that a certificate of probable cause be, and the same is hereby, issued and entered in the above-entitled cause and that the defendant is hereby ordered relieved from the payment of this judgment and [fol. 68] said judgment is ordered paid out of the proper appropriation from the United States Treasury.

/s/ Francis L. Van Dusen, United States District Judge.

....., 1957.

Approved as to Form only, G. Clinton Fogwell, Jr., United States Attorney, Alan J. Swotes, Assistant United States Attorney, Leon H. Kline, Attorney for Plaintiffs.

[fol. 69]

IN UNITED STATES DISTRICT COURT

Appellees' Appendix

EXCERPTS FROM TRANSCRIPT OF TESTIMONY

Testimony of Russell Huss.

Cross examination:

* * * * * * *

Q. Before the first of these Tower City stripping contracts was entered into, did the Huss Brothers partnership own any equipment?

A. Oh, yes.

Q. What equipment did you own?

A. We had two 2½ yard shovels, a 3½ yard, a yard and a half, two drills, a number of trucks—I would say in the neighborhood of 15 large trucks, coal haulage trucks, bulldozers, and so forth, and so on.

Q. This is the equipment you placed a value of how much on, sir, approximately?

A. I placed a value on the starting of that contract of about $100,000.

Q. You did not acquire that equipment for this contract; is that correct?

A. Not that particular equipment, not to start this contract.

[fol. 70] Q. Had you been using that same equipment on other coal stripping contracts?

A. Yes, we had, with the exception of the three and a half yard machines.

Q. Were those coal stripping contracts with the Philadelphia and Reading Coal and Iron Company?

A. No, they were not.

Q. How far removed was the tract on which you had been using this $100,000 worth of equipment?

A. Well, I moved one shovel about a mile and a half, and the other one I moved about three and half miles.

Q. How did you move the shovels, sir?

A. On their own power. It was possible to walk them from one mountain to another at that time.

Q. Well, did you have to pay to move any equipment on to that first contract?

A. It cost us a lot of money to move that equipment. You build roads. You can't move it through the bushes. I may not have paid outright for trailer hire or something of that sort any money, but you must build roads to walk the equipment over.

Q. Do you recall in this specific case that you built roads?

A. Oh, yes, I had to.

Q. To walk the equipment over?

A. Yes.

Q. How much did you pay for those roads, do you recall approximately?

A. I can't tell you at this date.

Q. You can't give us any testimony on what you paid to move that equipment on to this tract?

A. Well, I would say it would have run in the neighborhood of $15,000 to move that equipment in.

Q. What was that $15,000 expended for?

A. For roads and moving.

Q. Just roads?

A. Roads and moving.

Q. I understood the moving cost you nothing from the [fol. 71] standpoint of hiring somebody to do it for you.

A. You have to pay all of your labor. You have to pay for all of your supplies. It is the same as a working day.

Q. You are taking into account the cost of your own employees?

A. That's right. It all adds into that cost.

Q. How much of this $15,000 do you want to subtract for the cost of your own employees, gasoline and whatever else it takes to move the equipment?

A. Without the figures before me, I wouldn't say.

Q. You don't know?

A. No, I don't know.

Q. How much it cost you to move on that tract at this point you don't know, do you?

A. I made an estimate of 10 to $15,000.

Q. I am trying to break that down. How much of that 10 to 15 thousand do you want to subtract the cost of your own laborers from?

A. Well, I would have to be truthful, and which I tried to be, I would have to go over my records to see what my costs actually were for labor and supplies on that.

Q. Now, with respect to these Tower City stripping areas covered by the five contracts, were they contiguous areas adjacent to one another?

A. Yes, they were.

Q. You moved equipment off the first tract, let's say, on to one of the other tracts?

A. In some cases. In other cases I bought other equipment to put on those tracts.

Q. Is there any equipment that you purchased that was permanently affixed to any of these tracts and could not be feasibly removed?

A. No.

Mr. Berger: I object to that—I was going to say I object to the question because of the form in which it is put.

[fol. 72] Mr. Fink: What is the objection to the form, sir?

The Court: What is the question again?

(The last question and answer were read as above recorded.)

The Court: Would you state the reason for the objection?

Mr. Berger: I was wondering about the phrase "feasibly removed." I don't know what that means.

The Court: Couldn't be removed I think is what he means. Is that right?

Mr. Fink: Couldn't be removed. I assume you could tear down a lot of things, tear them down and destroy them. I added "feasibly."

By Mr. Fink:

Q. Did you understand?

A. I could move that from one tract to another. They were adjacent to one another.

It would be the same as if I started at Broad and Market and went down to Broad and South, and you had that area into contracts covering those areas, those five contracts.

Q. You had a labor force as well?

A. Oh, yes.

Q. You said you bought supplies and equipment. What does that consist of?

A. Well, it would be gasoline, fuel oil, motor oil, greases, cables, parts for your machinery.

Q. All of these items that you have described, sir. the labor force, fuel, and equipment, you took deductions on your tax returns for those as ordinary and necessary expenses of doing business, didn't you?

A. That's right.

And the equipment you have described here, sir, you got depreciation on, didn't you, sir?

A. That is correct.

* * * * * * *

[fol. 73] Q. Had the coal been put through any cleaning process when you took it to them?

A. At that time, no.

Q. You delivered it to a weigher, did you, so that it could be weighed in?

A. We delivered it across the scales.

Q. And an inspector checked to see whether it was acceptable or not?

A. The inspector checked it at the pit more so than at the scale, before——

Q. He was on the property itself?

A. Yes, before it was loaded in trucks.

Q. Were you given receipts for the coal that you delivered?

A. At the end of a day you got a sheet with the number of loads and the weights of the loads you hauled in.

Q. When were you compensated for that, sir?

A. On the 5th and 25th of each month.

Q. Did you have any concern with whether or not the Philadelphia and Reading Coal and Iron Company had sold that coal after you delivered it to them?

A. I would be concerned to the extent if they didn't sell it I didn't deliver any more.

Q. You were going to be paid for what you delivered whether or not they sold it?

A. That is correct.

Q. If the market price went up, did your rate of compensation change?

A. Only when the labor price changed.

Q. If the market price went down, did your rate of compensation change?

A. I wouldn't know. It never went down in those years.

Q. Now, sir, you know what you contracted for. If the market price had fallen and you had delivered the coal [fol. 74] to the Philadelphia and Reading Coal and Iron Company, they would have had to pay you your contract price; isn't that so?

Mr. Berger: I object to that. We have the contract in evidence. The question calls for a conclusion.

The Court: I will sustain the objection.

By Mr. Fink:

Q. During the years 1944 through 1948, was the Huss Brothers partnership stripping for anyone other than the Philadelphia and Reading Coal and Iron Company and the Stevens Company?

A. Yes.

Q. For whom, sir?

A. Jones Coal Company, Jack Jones, and the Peters Creek Coal Company.

Q. Do you recall, sir, that you claimed percentage depletion with respect to those contracts?

A. Yes.

Q. The Internal Revenue Service allowed them?

A. That is correct.

Q. It denied you percentage depletion only with respect to the two contracts or the two sets of contracts in issue in this lawsuit; isn't that so?

A. That's right.

Q. If coal was rejected by the Philadelphia and Reading Coal and Iron Company, you had no right to sell it elsewhere, did you, sir?

A. I never came into that proposition in those years. The coal market was such that you could sell all of the coal you could possibly mine.

Q. I know, but you described one incident in which some coal was rejected.

A. In later years.

Q. At which time if I correctly understood your testimony, you had to get an agreement from the Philadelphia and Reading Coal and Iron Company to let you endeavor to sell that coal elsewhere?

A. That is correct.

[fol. 75] Q. You had no right to sell that coal without their agreement?

A. No.

Q. That coal did not belong to you, did it, sir?

A. No, it did not belong to me.

Mr. Berger: I object to that as calling for a conclusion of law.

The Court: Mr. Fink, what is your reason in support of the question?

Mr. Fink: What is the point of my question, sir?

The Court: What is your reason in support of the question?

Mr. Fink: We are anxious to prove that the man has no economic interest. There was in his direct testimony a description of this incident of——

The Court: We have covered that.

Mr. Fink: I wasn't sure I clearly understood the time. I will withdraw the question.

The Court: I understand that you think that you may not have understood it, but you asked about three questions, and you came to a final question, and that is the question he is objecting to.

Mr. Fink: I will withdraw it rather than put your Honor to a ruling.

The Court: I am happy to rule. I want to have the record show what your reason for it is and what Mr. Berger's reason for objecting is.

Mr. Berger: Will you read the last couple of questions?

(The court reporter then read back the record as follows:

"Q. You had no right to sell that coal without their agreement?

A. No.

[fol. 76] "Q. That coal did not belong to you, did it, sir?

A. No, it did not belong to me.")

Mr. Berger: I move to strike the question and the answer.

The Court: The last question and answer?

Mr. Berger: Both. The last two.

The Court: The last two?

Mr. Fink: The one that it did not belong to him?

Mr. Berger: Yes. I said both of them have to deal with legal questions, and I am his counsel, and I will advise him what his rights are.

Mr. Fink: I will withdraw the question about the right to sell, but not the question of who did that coal belong to.

Mr. Berger: I certainly press my objection to that, sir.

The Court: I will allow it, and you can state in your brief why I should strike it out. I will allow both questions and answers, and you can cover them both in your brief.

Mr. Berger: All right, sir.

By Mr. Fink:

Q. After you got through with the stripping of Tower City and Forestville, what did you do with the equipment?

A. Well, Forestville finished before Tower City, and I moved that equipment up to Tower City. As Tower City finished up, we moved off on to other contracts in later years, but it was much later than these years in question.

Q. Well, was any of this equipment of Tower City during the years when it was in activity ever shifted over to the other operations during those years?

A. One—one two-yard dragline was shifted, which was [fol. 77] easy to move, from that operation to another one, and possibly back again as the demand for coal either rose or——

Q. You understood me when I said "other operations" to mean other operations which are not in issue in this lawsuit?

A. That's right, there was one small machine we juggled around.

Q. Who paid for the taxes on this property?

Mr. Berger: I object to that.

A. I don't know.

The Court: He doesn't know, so it is all right.

A. (Continuing.) I had nothing to do with that.

By Mr. Fink:

Q. Did you employ any office personnel back in Pottstown or Pottsville?

A. No, I didn't have any offices in Pottsville. My offices at that time were in Ringtown.

Q. In Ringtown.

Did you have an office there, sir?

A. Oh, yes.

Q. Bookkeeping personel, (sic) and so forth?

A. That is correct.

Q. And they serviced all of your operations; is that correct?

A. That is correct.

Q. Now, sir, I understood you to testify that the market price of coal was a factor taken into account in setting this price that you would receive. Did I correctly understand you?

A. That's right.

Q. How do you personally know that the Philadelphia and Reading Coal and Iron Company took that into account?

A. Well, when we first started to strip, and many other contractors started to strip, they started on what we termed as a 4-to-1 ratio because it kept the coal at a dollar value that they could make a dollar on.

[fol. 78] As the price on the retail market increased, they were able to pay more money and naturally went deeper to get the coal at a higher cost.

Q. But how do you know what they were deciding to compensate you on the basis of?

A. They would have to decide on the return on the ton of coal, and my position is that they could not afford to pay me $3 a ton for coal that they sold for $3 a ton and put it through a preparation plan.

Q. By this contract, however, they were obligated to do so if the price fell after you entered into the contract; isn't that so?

A. Or close the job down.

Q. The only adjustment they made for you, though, was that if your labor cost went up, they would give you an adjustment in price; is that correct?

A. That is correct.

* * * * * * * *

Testimony of CHARLES E. BROWN.

Direct examination.

* * * * * * *

Q. You don't recall any particular talk on the cancellation contracts?

A. No.

The Court: You mean on the cancellation clause of the contracts?

The Witness: That's right.

By Mr. Fink:

Q. Sir, do you have any authority from the Philadelphia and Reading Coal and Iron Company to alter the terms of their written contracts?

Mr. Berger: I object, your Honor.
The Court: I will overrule the objection.

A. No, sir, I do not.

[fol. 79] By Mr. Fink:

Q. Did Mr. Mulhoff——

Mr. Berger: I object.

By Mr. Fink:

Q. (Continuing.) —at this time?

The Court: Objection overruled.

A. No, he has not any authority either to change any of the contracts.

By Mr. Fink:

Q. In your capacity, sir, as supervisor of the stripping contracts in the Pottsville area, are you in charge of letting those contracts?

A. My authority is to obtain the bids, work up the economics of the bids and recommend the contractor to do the work.

Q. Are most of these contracts let on bids or by direct negotiation?

A. Most of it is on bids, competitive bids.

Q. Do you have any recollection whether the particular contracts in this case were let on bids or by negotiation?

A. If my memory serves me, these particular contracts, the P-22, I think at that time we negotiated that bid.

Q. You negotiated that one with Mr. Huss directly, or did you try other people at the same time?

A. I think—now, if my memory serves me—it was ten years ago—but at that particular time there were only certain contractors that had equipment, and it was necessary to use the contractors who had that equipment and negotiate a bid.

Q. Well, sir, before you negotiate a contract for the company or before you take bids on a contract for the company, do you and those under your supervision attempt to make some estimate of what a fair contract price would be?

[fol. 80] Mr. Berger: I object.

The Court: I will overrule the objection.

A. We do.

By Mr. Fink:

Q. What factors did you take into account, sir, in making your estimate?

A. We take into an account the amount of unclassified overburden that we are obliged to remove to obtain one ton of coal, giving expression to the type of material and endeavoring to work up a price which we think would be equitable for this particular kind of work from a contractor.

Q. Do you take into account the possibility of recoverable coal in the tract?

A. Yes.

Q. Do you take into account the length of the haul between that tract and whatever the designated delivery point is?

A. Yes, that is an element.

In other words, we take in all of the elements, depending on where the job is, what type the job is, where it is to go, and how it is to be prepared.

Q. You attempt to negotiate a price based on that estimate or accept bids based on that estimate; is that correct?

A. That's right.

Q. Once that contract has been let, is there any change in the contract price because of the change in the market price of the coal?

A. No, sir.

Q. If the market price of the coal falls below the price you have agreed to pay to the contractor, do you stand the loss unless you suspend work?

Mr. Berger: I object, your Honor.

The Court: Would you please read the question?

(The court reporter then read the last question as above recorded.)

[fol. 81] The Court: What is the reason for your objection?

Mr. Berger: Because we have already testimony with respect to the four years in question, and I suggest that the question be rephrased and based on the actuality, not on a hypothetical question.

The Court: I think that is a good suggestion.

Mr. Fink: Well, your Honor——

The Court: We are interested in these contracts, not what might be the practice in connection with other contracts.

Mr. Fink: That is true, and I will withdraw the question, but may I make this statement in connection with that?

We have had a considerable amount of discussion about the market price of coal, that it didn't go down, and that sort of thing. I am trying to get the legal principles here. Perhaps it is unnecessary to do it through a witness because we will have the contracts.

The Court: All right, but please make clear what you are asking. If you think it is relevant to show his general practice as being a person who arranged for contracts where strip mining is concerned, all right, if you are then coming down to the contracts in this case and that serves to qualify it, I think that would be proper. But what we are interested in, obviously, is the situation in this case.

Mr. Fink: Of course.

The Court: The situation as to these particular contracts.

[fol. 82] By Mr. Fink:

Q. Now, were those factors taken into account in fixing the prices in these contracts?

Mr. Berger: I object.

The Court: I will overrule the objection.

A. If I could understand your question, before we let a contract we make an economic study of the price obtaining. We study the market, the market price as far as we know, and then we go ahead on the contract whether the market goes up or down.

By Mr. Fink:

Q. I don't believe you did understand my question, sir, because you have testified to the factors you take into account in letting the stripping contract, and you have said you took into account overburden——

Mr. Berger: Just a moment. I object, your Honor. This is an attempt at cross examination because the counsel is not satisfied with the witness' response.

Mr. Fink: I want to be sure my question was understood.

The Court: Wait a minute, Mr. Berger. You can object and give your reason, but I believe what counsel is asking the witness at this time is whether the general considerations which the witness testified he took into account in setting the prices in contracts were in fact used in setting the prices under these contracts here. I think that is a relevant question.

Mr. Berger: Just so that I can make my point clear——

The Court: Certainly.

[fol. 83] Mr. Berger: I am objecting to the form of his questioning. I am suggesting that Mr. Fink is now cross examining the witness.

The Court: Well, I think that the question ought to be made clearer and more specifically related to these contracts, if that is what you are trying to get at, Mr. Fink.

Mr. Fink: Yes, your Honor. I think what has arisen is that I asked a question of the witness which I am not sure he understood. He has already testified as to what factors were taken into account by him——

The Court: Yes.

Mr. Fink: —in determining what the contract price should be, and then he gave me a response which I do not

believe, when I asked him a specific question about these considerations, was responsive. I think it was not clear.

The Court: I think what you ought to do is start over and rephrase your question and be very careful. I don't think you said anything about these contracts, and that is what confused him.

By Mr. Fink:

Q. What factors, sir, do you take into consideration normally in letting stripping contracts?

The Court: You have already gone over that.

Mr. Berger: I object.

By Mr. Fink:

Q. Did you take those factors into account in letting these contracts which are in issue in this lawsuit?

A. Yes.

[fol. 84] Q. Sir, is it any part of your job in letting these contracts to contractors to take into account the market price of the coal?

A. No, sir.

Q. Do you, however, have—strike that.

Are any studies prepared, however, of the possible market price of coal?

A. I would say yes, but not by the mining engineering department.

Q. Those would be prepared by the company?

A. By the company.

Q. When you recommend a contract to the company, what is your recommendation based upon?

Mr. Berger: I object to the form of that question.

The Court: I will overrule the objection.

Mr. Fink: Perhaps it is cumulative, your Honor, but I want to be sure the record is clear on this.

The Court: Let's not have any more argument. I have overruled the objection. Let's get on.

Will you read the question, please?

(The last question was read by the reporter, as above recorded.)

A. It is based upon the amount of work to be done for a certain amount of money.

Mr. Fink: No further questions.

Redirect examination.

By Mr. Fink:

Q. In recommending your price to the company in these cases, in the case of these contracts, you were considering the costs as you had them fixed as against your estimate or the estimate furnished to you on the future market [fol. 85] price of the coal; is that correct?

A. Yes, that is correct, that's right.

Q. And if the estimate of the future market price of the coal turned out to be a faulty estimate, would that change that contract price you had recommended?

Mr. Berger: I object, your Honor.

The Court: Objection overruled.

A. Well, I would think that in that particular case that may cause the termination of the contract.

By Mr. Fink:

Q. That might have caused the termination of the contract?

A. That's right.

The Court: By whom?

The Witness: By the company, by the coal company.

[fol. 92]

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 12,315
No. 12,317
No. 12,319

GEORGE HUSS, Appellant in No. 12,315,
RUSSELL HUSS, Appellant in No. 12,317,
WESLEY HUSS, Appellant in No. 12,319,

v.

FRANCIS R. SMITH, Collector of Internal Revenue, First District of Pennsylvania.

Appeal From the United States District Court for the Eastern District of Pennsylvania

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Argued December 19, 1957

Before: Biggs, Chief Judge; and Goodrich and Hastie, Circuit Judges.

OPINION OF THE COURT—Filed March 27, 1958

Hastie, Circuit Judge.

These appeals, like those we have decided today in *Parsons v. Smith*, F.2d , challenge a district court ruling that a contracting firm which extracted coal from [fol. 93] the land of another by strip mining was not entitled to claim a percentage depletion allowance in computing its income from that mining operation. Therefore, we will not repeat such of our discussion in *Parsons v. Smith* as presents legal conceptions common to all cases of this type. However, the controversies involve different arrangements between different parties concerning different tracts. And circumstances peculiar to a particular stripping arrangement may be decisive for or against the

claimed depletion deduction. Therefore it is necessary to consider separately and in some detail the facts upon which the stripper relies in this case.

The present contractor, a partnership which we shall call Huss, entered into a written agreement with the Philadelphia and Reading Coal and Iron Co., hereinafter called Reading, concerning the strip mining of certain coal lands owned by Reading. For this work Huss was to be paid an agreed dollar amount per ton of usable ore it should extract and deliver to a colliery designated by Reading. The agreed price was described in the contract as "full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work". The provisions of this contract which relate to compensation are certainly no more favorable to the taxpayers' depletion claim than were the rather similar provisions in the *Parsons* case. In neither case does anything agreed or done about compensation suggest that the stripper acquired an interest in the mineral in place.

On the other hand the facts relating to the duration of the stripping agreement in this case are somewhat different from those in the *Parsons* case. Huss continued to mine the contract area until the parties mutually agreed that additional stripping would not be profitable. In this sense Huss did mine the deposit to exhaustion. However, the stripping contract expressly provided that Reading could cancel the agreement, terminating it unconditionally [fol. 94] and without liability, on thirty days notice in writing. We are not told the reason for including this cancellation clause. We know only that it was part of the contract and that it was not invoked during the course of the mining operation under the contract.

In these circumstances there is more basis for argument here than there was in the *Parsons* case that the bargain contemplated such extensive mining of the area as would warrant characterization of the stripper's status as involving an interest in the mineral in place. Indeed, certain recent decisions of the Court of Appeals for the Fourth Circuit suggest the reasonableness of such an analysis on facts not very different from those here. See *Commis-*

sioner of Internal Revenue v. Hamill Coal Corp., 1956, 239 F.2d 347; *Weirton Ice & Coal Supply Co. v. Commissioner of Internal Revenue*, 1956, 231 F.2d 531. But to us the most that can be said for the stripper's position on the present record is that reasonable men can differ on the inferences they draw from the facts and in the relative values they attribute to various facts in determining the category in which the total situation belongs. Indeed, this contract did not give the stripper the privilege of mining all uncovered coal after notice of termination, which in the *Parsons* case was thought to strengthen the stripper's claim to an interest in the mineral in place. Certainly a reasonable trial judge could view the absolute right of termination on thirty days notice as more significant than the fact that this privilege was not exercised in the given case. And this in substance is what the trial judge did. We cannot find reversible error in this evaluation of the evidence in relation to the rather vague standard the courts must administer in these cases.

Finally, we note that Huss invested a considerable larger sum than did the plaintiffs in the *Parsons* case in drilling and earth moving equipment. At one time Huss committed about $500,000 worth of equipment to this job. [fol. 95] However, the district court found that, except for one item, all of this equipment had utility for stripping operations in general rather than special adaptation to this project. Nothing appears which distinguishes such expenditures from capital expenditures normally made by independent contractors who undertake large projects in such familiar fields as road building and general construction.

We are satisfied that the conclusion of the district court was consistent with the rational application of the legal standards stated in the statute and the implementing Treasury Regulations to the facts at hand. That is enough to require affirmance.

A separate issue is raised on this appeal with reference to so much of the judgment below as denied appellants any depletion allowance for strip mining prior to December 31, 1944 under certain other agreements called the "Stevens contracts". This ruling was explicitly based upon the trial court's conclusion that the taxpayers, who as plaintiffs be-

low had the burden of proof, had failed to establish the existence prior to 1945 of such an agreement as would support a depletion allowance. We have examined the evidence on this branch of the case. It is not so clear and convincing as necessarily to persuade any reasonable trier of fact. We must, therefore, sustain the trial court's finding against the appellants on the facts.

The judgment will be affirmed.

[fol. 96]

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12315 (D. C. No. 14775)

GEORGE HUSS, Appellant,

vs.

FRANCIS R. SMITH, Collector of Internal Revenue, First District of Pennsylvania.

On Appeal from the United States District Court for the Eastern District of Pennsylvania.

Present: Biggs, Chief Judge and Goodrich and Hastie, Circuit Judges.

JUDGMENT—March 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

[fol. 97]

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12317 (D. C. 14776)

RUSSELL HUSS, Appellant,

vs.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,
First District of Pennsylvania.

On Appeal from the United States District Court for the Eastern District of Pennsylvania.

Present: Biggs, Chief Judge and Goodrich and Hastie, Circuit Judges.

JUDGMENT—March 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

[fol. 98]

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12319 (D. C. 14777)

WESLEY HUSS, Appellant,

vs.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,
First District of Pennsylvania.

On Appeal from the United States District Court for the Eastern District of Pennsylvania.

Present: Biggs, Chief Judge and Goodrich and Hastie, Circuit Judges.

JUDGMENT—May 27, 1958

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

[fol. 102]

IN UNITED STATES COURT OF APPEALS

PETITION FOR REHEARING—Filed April 25, 1958

Plaintiffs, George Huss, Russell Huss and Wesley Huss, petition for rehearing pursuant to Rule 33 of the Rules of this Court, upon the following grounds:

1. The Decision of the Court Rests in Part Upon an Error With Respect to the Content of the Record.

The Court, in disposing of the instant cases and the companion appeals in *Parsons v. Smith* (Opinion filed March 27, 1958), gave particular weight to the reasons for the inclusion of termination rights in the stripping arrangements, in determining whether the operations were of such character as to warrant the conclusion that the stripper held an economic interest in the mineral in place.

Thus, in the *Parsons* case, the Court took the view that the desire of the stripper to return at the earliest date to road building, which resulted in the inclusion in the stripping arrangement of a *mutual* ten-day termination clause, indicated the absence of intent to mine to exhaustion.

In the instant cases, the Court said with respect to the so-called thirty-day cancellation privilege of Reading:

"We are not told the reason for including this cancellation clause. We know only that it was part of the con-

tract and that it was not invoked during the course of the mining operation under the contract." (Slip Opinion, p. 3.)

The attention of the Court is respectfully called to the testimony of Russell Huss (App. 10a-12a), that the purpose of the termination clause, as represented to him by the Reading representatives, was to insure the responsibility of the stripper, i.e., to avoid difficulties inherent in terminating the rights of a stripper who proved to be unsatisfactory.

Even without this record, this Court concluded that the plaintiffs have a stronger claim to the characterization of [fol. 103] their status as involving an interest in the mineral in place, and noted that "on facts not very different" the Court of Appeals for the Fourth Circuit had decided in favor of the stripper.

Certainly the disclosure of such record demands reconsideration of this Court's determination to rely upon the exercise of judgment by the district judge on the ground that "on the present record" (Slip Opinion, p. 3), reasonable men could differ on the inferences they draw from the facts and in the relative values they attribute to various facts in determining the category in which the total situation belongs. The district court, it should be observed, refused to consider the testimony above referred to on the ground that it was irrelevant as an attempt by oral evidence to vary the terms of a written contract. However, in the light of the approach of this Court, it is highly relevant to negate a harmful inference of the kind drawn in the *Parsons* case, as well as to substantiate the claim of plaintiffs that extensive strip mining was contemplated by the parties.

It is respectfully submitted that this record renders irresistible the conclusion that the bargain contemplated such extensive mining as to require characterization of the stripper's status as involving an interest in the mineral in place; particularly is this so in light of the additional record facts not simply that plaintiffs actually mined to exhaustion, but especially that the rights of the parties were in fact terminated only by their mutual agreement in writing, and not by unilateral action of Reading.

2. The Decision of the Court Is in Conflict With the Decisions of the Court of Appeals for the Fourth Circuit as Well as the Settled Law of Appellate Review.

This Court indicated (Slip Opinion, p. 3) that, "on facts not very different from those here," the Fourth Circuit has reached a contrary conclusion: *Commissioner v.* [fol. 104] *Hamill Coal Co.*, 239 F. 2d 347 (1956); *Weirton Ice & Coal Supply Co. v. Commissioner*, 231 F. 2d 531 (1956). Indeed, in the latter cases, the Fourth Circuit did not have before it evidence of the character already discussed in this Petition. (The view of the Fourth Circuit is quoted at page 13 of the Plaintiff's brief originally submitted to this Court.)

While recognizing the reasonableness of the analysis of the *Hamill* and *Weirton* decisions, this Court finds the differentiating factor to be the district judge.

Thus, this Court states (Slip Opinion, p. 3):

> "But to us the most that can be said for the stripper's position is that reasonable men can differ on the inferences they draw from the facts and in the relative values they attribute to various factors in determining the category in which the total situation belongs. • • • Certainly a reasonable trial judge could view the absolute right of termination on thirty days notice as more significant than the fact that this privilege was not exercised in a given case. And this, in substance, is what the trial judge did."[1]

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[1] It is submitted that this is not what the district judge did. A reading of the discussion contained in the district court's Opinion (App. 52a-58a) leads to the conclusion that it was unaware that it was dealing in an area of choice. Rather, on the principal issues, market price and terminability, the district court concluded that it was bound by this Court's decision in *Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535 (1955), cert. denied 352 U. S. 824. In this respect it was wrong.

In that case, the stripper had first to offer the coal produced to Mammoth at the contract price; if Mammoth did not require the coal, the stripper was free to sell elsewhere. This Court said that in either event, the stripper was dependent upon production for its return. The district court, erroneously, interpreted this as a

[fol. 105] It is respectfully submitted that this conflicts directly with the decisions of the Court of Appeals for the Fourth Circuit, in which the conclusions of the Tax Court were reversed.

The attempt of this Court to distinguish the instant decision upon the ground given is at variance with the settled law of appellate review where, as here, the facts are not in dispute. Indeed, the Court has in effect adopted the moribund philosophy of *Dobson v. Comissioner*, 320 U. S. 489 (1943), which even in the fullness of vitality was never applicable in the review of judgments of district courts. Certainly in none of the depletion cases cited in the briefs of either the plaintiffs or the government has the appellate tribunal ceded preference to what, in cases of undisputed facts, can only be the legal conclusions of the trial court; and one may witness the unsuccessful plea of the dissent in *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25, 37 (1946). See also, *Commissioner v. P. G. Lake, Inc.*, —— U. S. —— (April 14, 1958).

The Court of Appeals for the Third Circuit has been foremost in recognizing that reasoning from undisputed facts, particularly in connection with statutory concepts, is the responsibility, on review, of the appellate court. In *Brown v. Commissioner*, 131 F. 2d 640 (1942), this Court stated the case:

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requirement that the stripper be permitted to sell elsewhere, and noted that in the instant case the coal was not an "asset" of the Huss brothers. It overlooked the fact that in the *Mammoth* case, any sale elsewhere was at the sufferance of Mammoth. In the instant case, Reading was required to take all of the saleable coal, and the only coal rejected was inferior, non-commercial coal. No problem therefore arises concerning rejected coal. The fact remains that, as with the stripper in the *Mammoth* case, Huss brothers were dependent upon production for their return.

As to terminability, this Court, in the *Mammoth* case, on petition for rehearing, noted that the issue of terminability raised in *Usibelli v. Commissioner*, 229 F. 2d 539 (9th Cir. 1955), was not before it. The district court, erroneously, concluded that this Court regarded non-terminability as essential to the stripper's claim to depletion. Indeed, the opinion in the instant case belies that conclusion, and even the Court in *Usibelli* regarded terminability as a secondary factor.

"Ownership, while based on facts is, we think, a legal concept. If a man has a sufficient number of rights, powers, privileges and immunities with respect to a thing he is, in law, regarded as the owner of it. The number of units in the bundle which makes him an owner for the purpose of property law does not necessarily control the question whether a different number of units makes him the owner with respect to liability [fol. 106] for taxation, as the authorities cited above establish. Whether the settlor of a trust retains a sufficient number to make him liable for the income of the trust as its 'owner' we think is a conclusion of law which this Court, in reviewing the decision of the Board of Tax Appeals, must take the responsibility." (131 F. 2d, at pages 641-642.)

To the same effect are: *In re Kellet Aircraft Corp.*, 186 F. 2d 197, 200 (1950); *Ball v. Paramount Pictures*, 169 F. 2d 317 (1948), cert. denied 339 U. S. 911; *Kuhn v. Princess Lida*, 119 F. 2d 704, 705 (1941).

Accordingly, the conflict with the decision of the Fourth Circuit is patent, and not justified by the review accorded to the plaintiffs in this case. The record in this case overwhelmingly establishes that the real understanding of the parties was that the plaintiffs would be permitted, as they were bound to do, to mine to exhaustion; certainly, at least, to continue strip mining for a substantial period of time.

This Court has erroneously permitted to stand the district court's asserted legal conclusion that plaintiffs had no economic interest in the coal in the place, but upon a completely independent review, that conclusion should be reversed.

3. The Opinion of the Court Is Further Inconsistent With the Decision of This Court in *Mammoth v. Commissioner*, and Reflects a Misconception of Requirements for the Depletion Deduction.

This Court has referred to the "vague standards the courts must administer in these cases." Nevertheless, the decisions of the Supreme Court of the United States furnish an effective guide. Without attempting to repeat the

detailed argument contained in the plaintiffs' brief previously submitted, it must be repeated that a taxpayer is entitled to depletion where he has: (1) acquired, by investment, any interest in the mineral in place, and (2) secured [fol. 107] by legal relationship income derived from the extraction of the mineral, to which he must look for a return of his capital. *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308, 314 (1956), quoting *Palmer v. Bender*, 287 U. S. 551, 557 (1933). As the Supreme Court pointed out, 350 U. S. at 314, the second factor has been interpreted to mean that the taxpayer must look *solely* to the *extraction* of the mineral for his return. In the instant case the plaintiffs were solely dependent upon production for their return. Nothing contained in any of the depletion cases either in the Supreme Court or the Courts of Appeal requires that the producer's return from his production must fluctuate with the market. Indeed, in this respect the determination of this Court is inconsistent with the prior decision of the Court of Appeals for the Third Circuit in *Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535, 538 (1955). See footnote 1, *supra*. It is inconsistent in this respect with the cases decided by the Court of Appeals for the Fourth Circuit.

This Court has emphasized that the price constituted full compensation for all work, and for the materials, labor, machinery, etc. This catalogue is no different from that in the *Mammoth* case. But it is apparent that this was Reading's assurance that it was required to pay only for coal produced, negating any possibility of responsibility for the work of production, and places upon plaintiffs the full risk and burden of production.

The true nature of the arrangement between Reading and the plaintiffs is recorded in Article 5 of the Agreement (App. 37a):

> "The term 'salvage stripping' as used herein shall be deemed to mean a project wherein [Reading] reserves a coal-bearing area for [plaintiffs], gives [plaintiffs] permission to enter upon this area and strip it, and agrees to pay [plaintiffs] a specified amount of money [fol. 108] for each ton of raw coal that [plaintiffs] deliver to [Reading] * * *. In a 'salvage stripping'

> project [Reading] assumes no responsibility for the discovery of coal, gives [plaintiffs] no guarantee of the quantity of coal in the stripping area and places upon [plaintiffs] all risk in connection with the prospecting, discovery and recovery of coal and the operation of the entire stripping project."

It is plaintiffs' position that they have clearly met the second of the two requirements for the depletion allowance. To the extent that this Court found (Slip Opinion, p. 2) nothing of significance in the compensation of plaintiffs, it was in error.

As to the first requirement, it is significant that the term "capital investment" as used in this category of the law, is synonymous with "economic interest." *Burton-Sutton Oil Co. v. Commissioner,* 328 U. S. 25, 29, 32 (1946). This Court has omitted to observe that the requisite economic interest may arise otherwise than through the conventional method of purchase or similar contribution of money or property. No money need actually be invested in the deposit. *Commissioner v. Southwest Exploration Co.,* 350 U. S. 308, 312 (1956). A capital investment may be acquired through gaining a share in the control over extraction or the right of production of the mineral in place. Thus, in *Burton-Sutton Oil Co. v. Commissioner,* it was said the necessary economic interest in the mineral in place arose through "control over extraction." 328 U. S., at 34. It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. Legal ownership may exist in another, but where control over production exists, such person acquires an economic interest which represents his capital investment and is subject to depletion. *Palmer v. Bender, supra; Lynch v. Alworth-Stephens Co.,* 267 U. S. 364 (1925).

It is undisputed that the allowance for depletion is not dependent upon the legal form of the taxpayer's interest. [fol. 109] The designation of the transaction as a lease, contract, project, or otherwise, is not controlling; only its practical consequences. Whether Reading "leased" to plaintiffs the area or merely "reserved" it, the economic consequences

are the same. And whether Reading reserved a royalty of cash or kind, the economic consequences are the same: for Reading is thereby preserving its economic interest—or capital investment—in the coal in place. That Reading exacts the requirement, in lieu of royalty, that all coal produced be delivered to it at a specified price does not change the character of plaintiffs' interest in the coal in place. At best, it indicates the economic interest of Reading which entitles it to share in the depletion allowance—for Reading did not reserve a royalty or other right in the coal produced, and except for this reservation it would be deemed to have transferred its entire interest in the coal in place. In this respect, Reading merely traded its right to royalty for the right to receive the coal produced at a specified price. The reservation of a reversion by Reading is not material.

Plaintiffs were the producers. Their agreements gave them the right to enter and mine the coal; even though legal ownership in a technical sense remained in the lessor, Reading, they nevertheless acquired an economic interest in the coal which represented their capital investment. They depended solely upon production for their possibility of profit or the return of their investment. No more is required for the depletion allowance.[2] The law requires an economic rather than a legal interest in the oil in place, and to the extent that the Opinion of this Court suggests a different philosophy, it is in error.

[fol. 110] Moreover, there is in this case, even in a literal sense a real and unequivocal capital commitment unobserved by this Court: plaintiffs were obligated to enter

[2] Despite what this Court said in the *Parsons* Opinion (Slip Opinion, pp. 6-7) concerning *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308 (1956), the contribution of the use of their land by the upland owners did not alone establish their economic interest in the oil in place. The upland owners owned no direct legal interest in the oil, and the agreements did not give them a right to enter and drill for oil. It was proximity to the offshore deposits and the effect of the state law which combined to make them parties to any drilling operation. It was this "controlling" position which the Supreme Court emphasized. Quite obviously, the necessary economic interest can be created by the parties through legal forms, the effect of which is the transfer of a right to enter and to extract the mineral.

and to mine to exhaustion. And it was in this sense that they committed their capital resources unreservedly. The purchases of $500,000. of equipment—which this Court and the district court disregarded as depreciable items—constitute tangible expression of this capital commitment. The fact that the equipment was usable for other stripping ventures does not detract from the fact that it was an investment for the stripping projects here involved.

It is respectfully submitted, therefore, that a rehearing is warranted in this case, and that the judgment of the district court should be reversed.

4. With Respect to the "Stevens" Contracts for the Year Prior to 1945, the Court Failed to Recognize That No Issue of Fact Is Involved.

The district court allowed depletion to plaintiffs with respect to the so-called "Stevens" contracts, except for the year prior to 1945. It denied depletion for such year on the ground that plaintiffs failed to establish an *exclusive* right to mine. The area involved was owned by the Commissioners of Schuylkill County (Pennsylvania). In 1944, or prior thereto, the Commissioners made an arrangement with "Western Anthracite," so that thereafter mining rights could only be obtained from it. Plaintiffs' witness, Russell Huss, in his testimony, said that anyone could have obtained mining rights from the Commissioners before they made their arrangement with Western Anthracite (16a). The district court took the view that therefore plaintiff failed to show its rights in 1944 were exclusive. This is a plain mistake. The witness' statement that "anyone" could have made an agreement with the Commissioners did not refer to the terms or conditions of such rights; it merely signified that this was not true after the Western Anthracite arrangement (16a). That this is so, [fol. 111] and that plaintiffs' rights were exclusive is indisputable on the record: the plaintiffs' witness testified that at all times the mining rights they had were exclusive (20a). This is clear particularly because the witness referred to all of the mining rights with respect to the particular tract involved as "Stevens contract" since he sold all the coal produced to Stevens (15a), and on cross-

examination he stated that *all the rights* plaintiffs had were obtained from Western Anthracite (27a). The district court found that rights obtained from Western Anthracite entitled plaintiffs to the depletion deduction, and this is not contested here.

Accordingly, it is submitted that the district court was plainly wrong, that there is no issue of fact in dispute, and that this Court should have set aside the finding of the district court.

5. Conclusion.

For the reasons given, a rehearing should be granted to plaintiffs and the judgments of the district court reversed.

Respectfully submitted,

Leon H. Kline, Murray Milkman, Attorneys for Appellants.

Of Counsel: Berger and Gelman, 1220 P.S.F.S. Bldg., 12 South 12th St., Philadelphia, Pa.

[fol. 112]

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 12,315
No. 12,317
No. 12,319

GEORGE HUSS, Appellant in No. 12,315,
RUSSELL HUSS, Appellant in No. 12,317,
WESLEY HUSS, Appellant in No. 12,319,

v.

FRANCIS R. SMITH, Collector of Internal Revenue, First District of Pennsylvania.

Sur Petition for Rehearing

Present: Biggs, Chief Judge; and Maris, Goodrich, Staley and Hastie, Circuit Judges.

OPINION OF THE COURT—Filed May 29, 1958

Per Curiam:

The petition for rehearing considered, we adhere to our view that the record affords adequate basis for the conclusion of the trial court that the stripper did not have a depletable interest in the mineral in place. It is strongly urged in the present petition that decisions of the Court of Appeals for the Fourth Circuit, cited and discussed in our opinion on this appeal, reach a contrary result on very similar facts. We are not sure what that Court of Appeals would do in reviewing a decision against the stripper on the facts of our case. But regardless of that, we are still persuaded that an affirmance is proper.

The petition will be denied.

[fol. 113] KALODNER, *Circuit Judge*, dissenting

I would grant the petition for rehearing. Further, on rehearing I would reverse the judgment of the district court on the principal issue involved—the existence of an economic interest.

The Supreme Court has charted the course and the law in cases of this type. Only recently it stated, firmly and concisely, that a taxpayer is entitled to the depletion deduction "where he has: (1) 'acquired, by investment, any interest in the oil in place', and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital'". Commissioner v. Southwest Exploration Co., 350 U. S. 308, 314 (1956).

"These two factors usually considered together", said the Supreme Court in the Southwest Exploration case, "constitute the requirement of 'an economic interest.'"

Nothing was said by the Supreme Court in that case on the score as to the impact of a right of termination of a contract creating an economic interest on the existence of that interest in the first place. Nor has the Supreme Court said so in any other case. We did not consider nor did we pass upon this question in Commissioner v. Mammoth Coal, 229 F.2d 255 (1955). Nor has any other appellate court done so except the Fourth Circuit. That Circuit, however, has

explicitly ruled that a right of termination does not destroy an economic interest which existed prior to its exercise. It did so in two cases: Weirton Ice and Coal Supply Co. v. Commissioner, 231 F.2d 531, 533 (1956) and Commissioner v. Hamill Coal Corp., 239 F.2d 347 (1956).

In Weirton it was said (p. 535):

> "It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the [fol. 114] event proved, Weirton actually mined the coal during all the taxable years."

In Hamill, the contract (entered into in 1944) was to continue for one year and from year to year thereafter with the right of either party to terminate it at any time upon 90 days' written notice. The contract was terminated in 1947 by mutual agreement "after Daniel [the stripper] had removed substantially all the coal with an overburden of less than 40 feet." (p. 349).

In Weirton the decision does not disclose when mining operation ceased or whether the stripper ever mined to exhaustion. In Hamill, however, the record discloses that subsequent to termination the owner of the mine actually mined some 90,000 tons of coal.

In the instant case it is undisputed that the stripper (taxpayers) mined to exhaustion and that the contracts were terminated by mutual agreement after such exhaustion so that the factual situation here is much stronger than in either Weirton or Hamill.

I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right.

It is not necessary, however, that I go as far along the course stated in the decision of the instant case. The record here discloses that the termination clause was in-

cluded in the contract as a precaution on the part of the owner to protect itself from possible difficulties with an incompetent stripper.[1] It may be noted parenthetically that [fol. 115] in the opinion sought to be reconsidered it was erroneously stated "We are not told the reason for including this cancellation clause."

Assuredly, prior to the exercise of the termination clause, taxpayers here "had an economic interest in the oil [coal] in place through its [their] control over extraction." Burton-Sutton Oil Co., Inc. v. Commissioner, 328 U.S. 25, 34 (1946). That control, moreover, actually existed, as already said, until the property was mined to exhaustion. Further, as stated in Burton-Sutton Oil Co. "Depletion depends only upon production".

It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312.

There is no room for doubt that the taxpayers had the requisite control over production, for under the contracts, the Coal Company gave to taxpayers the exclusive right to mine all of the merchantable coal in place in the leased area. That such right might have been brought to an end does not affect the present fact that the economic interest existed.

There is also no room for doubt that the taxpayers depended solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including, but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operation profitable.

Until now, every appellate decision in this type of case, including our own decision in Commissioner v. Mammoth Coal Co., supra, has held that there is no requirement that the stripper must assume the risks of the ultimate market.

---

[1] Russell Huss testified (p. 60 N.T.) that the termination clause "was put in there in a form contract so as if they got hold of a contractor who was not reputable, who wouldn't live up to the contract, they could put him off the property without court action."

To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the [fol. 116] Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, Commissioner v. Southwest Exploration Co., 350 U.S. at page 314, that the taxpayer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do.

Although we said, in Commissioner v. Mammoth Coal Co., 229 F.2d at page 537, that "The facts in each case determine the result", I do not regard such declaration as an admission that the criteria to be applied are too vague to do so on other than the basis of "the reasonable man". To the facts must be applied statute and the specific rules pronounced by the Supreme Court in the interpretation of it. That is the teaching of Commissioner v. Southwest Exploration Co., supra.

I conclude, therefore, that the taxpayers during the taxable years involved had the requisite economic interest in the coal in place. This, to me, is the result required by the decisions of the Supreme Court, the Fourth Circuit, and this Court; and our present decision is inconsistent therewith.

Accordingly, I would grant rehearing and reverse the judgments of the district court.

[fol. 117] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[Title omitted]

Present: Biggs, Chief Judge; and Maris, Goodrich, Staley and Hastie, Circuit Judges.

ORDER DENYING REHEARING—May 29, 1958

After due consideration the petition for rehearing in the above-entitled case is hereby denied.

[fol. 119] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 120]

SUPREME COURT OF THE UNITED STATES

No. 305, October Term, 1958

[Title omitted]

ORDER ALLOWING CERTIORARI—October 13, 1958

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted. The case is consolidated with No. 218 and a total of two hours allowed for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 121]

EXHIBIT P-1

CONTRACT
SPECIFICATIONS
DRAWINGS
STIPULATION AGAINST LIENS

FOR

STRIPPING AND MINING THE VARIOUS VEINS ON THE NORTH AND SOUTH DIPS AT THE TOWER CITY SECTION IN AREAS DESIGNATED BY THE COAL COMPANY ENGINEER—STRIPPING NO. P-22.

The Philadelphia & Reading Coal & Iron Co.
Pottsville, Pennsylvania.

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THE PHILADELPHIA AND READING COAL AND IRON COMPANY
Pottsville, Pennsylvania

CONTRACT

FOR

STRIPPING AND MINING THE VARIOUS VEINS ON THE NORTH AND SOUTH DIPS AT THE TOWER CITY SECTION IN AREAS DESIGNATED BY THE COAL COMPANY ENGINEER—STRIPPING NO. P-22

THIS MEMORANDUM OF AGREEMENT, made and entered into this 27th day of May in the year 1944, between GEORGE W. HUSS, RUSSELL N. HUSS and WESLEY W. HUSS, Partners, trading and doing business as GEORGE W. HUSS CONTRACTING COMPANY, a Partnership operating in the State of Pennsylvania (hereinafter referred to as "CONTRACTOR"), party of the first part, and and THE PHILADELPHIA AND READING COAL AND IRON COMPANY, a corporation of the State of Pennsylvania (hereinafter referred to as "COAL COMPANY"), party of the second part,

WITNESSETH: That for and in consideration of the mutual agreements herein contained, it is agreed by and be-

tween the parties hereto, for themselves, their successors, heirs, executors, administrators and assigns as follows:—

PART ONE.—GENERAL

Article 1.—Description of Project.

It is the understanding of the parties hereto that this project is a "salvage stripping" operation. Contractor agrees to assume all risk connected with the prospecting, discovery and recovery of all the coal that is recoverable by stripping in the areas designated by the Coal Company Engineer.

Contractor does also hereby covenant, promise and agree, for the consideration hereinafter named, to do all work and provide all the material, labor, tools, equipment, water, light, power, transportation and other facilities, unless specified otherwise hereinafter, required for the excavation, removal and disposal of all overburden material and divider slate lying over, between and/or in the veins of coal and for mining, transporting, and delivery into the raw coal chute at Westwood Breaker of all the raw coal that is recoverable by stripping within the areas designated by Coal Company Engineer and within the limits set forth by said Coal Company Engineer, all the above to be done in accordance with the Contract Documents referred to herein and hereto attached, and under the direction and to the satisfaction of Coal Company Engineer.

[fol. 127] Article 2.—Location and Limits of Project.

It is the understanding of the parties hereto that the project referred to above is the stripping areas in the various veins on the North and South Dips at the Tower City Section, as designated by the Coal Company Engineer, and located on the Munson and Williams Lands, Porter Township, Schuylkill County, Pennsylvania, which lands are owned by Coal Company.

It is further understood by the parties hereto that the minimum acceptable stripping ratio shall be an average

for the entire project of four (4.0) place cubic yards of overburden per gross ton of raw coal recovered.

PART TWO.—PRELIMINARY CONSIDERATIONS.

Article 3.—Contractor's Familiarity With Project.

It is the understanding of the parties hereto that Contractor has carefully examined all data available concerning the stripping area, has visited the site, has fully informed himself as to all existing conditions and limitations including all laws, ordinances and regulations affecting the contract or the work and has included in the bid price a sum sufficient to cover the cost of all items implied or required to attain the completed conditions contemplated by the contract.

It is further understood that Contractor has familiarized himself with the features and details of the project insofar as they may tie in with his work.

Failure to have complied with the above shall not relieve Contractor of any of the obligations of the contract.

Article 4.—Contract Documents.

The Contract Documents consist of the following parts and each is as fully a part of this contract as if herein inserted at length:

Contract.
Specifications.
Drawings.
Stipulation Against Liens.

These documents are together the documents governing in the execution of this contract and are hereinafter referred to collectively as the "Contract Documents".

The Contract Documents shall be signed in triplicate by Coal Company and Contractor. In case of failure to sign the Specifications, Coal Company shall identify them.

[fol. 128] Article 5.—Definition of Terms.

The term "raw coal" as used herein shall mean the mixture of coal, divider slate and extraneous refuse as it is taken from the stripping.

The term "salvage stripping" as used herein shall be deemed to mean a project wherein COAL COMPANY reserves a coal-bearing area for CONTRACTOR, gives CONTRACTOR permission to enter upon this area and strip it, and agrees to pay CONTRACTOR a specified amount of money for each ton of raw coal that CONTRACTOR delivers to COAL COMPANY at a point and under certain conditions specified by COAL COMPANY. In a "salvage stripping" project COAL COMPANY assumes no responsibility for the discovery of coal, gives CONTRACTOR no guarantee of the quantity of coal in the stripping area and places upon CONTRACTOR all risk in connection with the prospecting, discovery and recovery of coal and the operation of the entire stripping project.

The term "raw coal chute" at Westwood Breaker as used herein shall mean the structure located at Westwood Colliery and is of a suitable design to permit the dumping of the raw coal as contained in the trucks of CONTRACTOR.

"COAL COMPANY ENGINNEER" referred to in the Contract Documents is the Division Engineer (or his authorized representative) of COAL COMPANY Operating Division of which the stripping and mining project covered herein is a part.

The term "subcontractor", as employed in the Contract Documents, includes only those having a direct contract with CONTRACTOR.

"Written Notice" shall be deemed to have been duly served if delivered in person to CONTRACTOR, or to a member of the firm, or to an officer of the corporation for whom it is intended, or if delivered or sent by registered mail, to the addressee at the last business address known to him who gives the notice.

The term "Cubic Yard" as employed in the Contract Documents with reference to overburden is the volume of the overburden material as it exists in place before the start of the proposed work.

The term "Drawings" as employed in the Contract Documents shall be deemed to include all plans, sections, maps, blue prints, photostats, sketches and other similar documents, whether general or detail.

The term "Ton" as employed in the Contract Documents, shall be deemed to mean a gross ton of 2240 pounds.

The term "Overburden" as employed in the Contract Documents, shall be deemed to mean all materials, other than "Divider Slate" and acceptable coal, which it is necessary to excavate, handle, remove and/or dispose of in the course of the work covered by this Contract.

[fol. 129] The term "Extraneous Refuse" as employed in the Contract Documents, shall be deemed to mean material originating outside of the vein or veins or within the vein or veins in the form of major partings which are of such nature and thickness as can, in the opinion of COAL COMPANY ENGINEER, be removed separately from the coal by power shovel.

The term "Divider Slate" as employed in the Contract Documents, shall be deemed to mean any slate, rock or other material (other than acceptable coal) which may be found to exist within the limit of the coal vein or veins included within this stripping and mining operation.

All time limits stated in the Contract Documents are of the essence of the contract.

Article, Section and Paragraph headings and titles are for convenience of reference only, and shall not be construed to affect in any manner the scope or meaning of any article, section or paragraph of this contract.

Throughout the Contract Documents, COAL COMPANY is referred to as neuter gender and singular number and CONTRACTOR as masculine gender and singular number.

ARTICLE 6.—CONTRACT SPECIFICATIONS AND DRAWINGS.

CONTRACTOR agrees that the drawings referred to in the Specifications shall be deemed a part of the Contract and that this Contract, the Specifications and Drawings, are to be considered together in the execution of the Contract.

ARTICLE 7.—SUFFICIENCY OF SPECIFICATIONS.

CONTRACTOR admits that the Specifications are sufficient for their intended purpose; the purpose of the Specifications being to describe the stripping areas and set forth other conditions that CONTRACTOR must fulfill on the project; CONTRACTOR further covenants and agrees to be governed in each case by detail specifications which are to be deemed

a part of the Specifications referred to herein and made a part hereof, although said detail Specifications may not be prepared until after the commencement of said work.

ARTICLE 8.—DIRECTION OF WORK PERFORMED.

CONTRACTOR agrees to perform all work hereunder in accordance with directions that may from time to time be given to CONTRACTOR by COAL COMPANY ENGINEER.

[fol. 130] PART THREE.—OBLIGATIONS OF CONTRACTOR

Work To Be Done

ARTICLE 9.—WORK TO BE DONE BY CONTRACTOR.

CONTRACTOR agrees to perform all work required for the prospecting, discovery and recovery of all coal; the removal of overburden; and for the delivery of raw coal into the Raw Coal Chute at Westwood Breaker located at Westwood Colliery and owned by COAL COMPANY; all the above to be done to the extent and under conditions described in the Contract Documents.

ARTICLE 10.—ITEMS TO BE PROVIDED BY CONTRACTOR.

Unless otherwise stipulated, CONTRACTOR agrees to provide and pay for all materials, labor, tools, equipment, water, light, power, transportation and other facilities necessary for the execution and completion of the work. Materials or work described in words which so applied have a well-known technical or trade meaning shall be held to refer to such recognized standards.

ARTICLE 11.—DETERMINATION OF SCOPE OF WORK.

The term "Scope of Work" as used herein is understood by the parties hereto to refer to everything required to extract, process and deliver into the raw coal chute at Westwood Breaker, all of the raw coal that is recoverable by stripping within the areas of the project described in Articles 1 and 2.

It is the understanding of the parties hereto that the Scope of Work will be determined and controlled by the actual conditions found to prevail with respect to the project and that these conditions must be ascertained by prospecting and proving to be done by the CONTRACTOR at his expense and under the direction of the COAL COMPANY ENGINEER.

ARTICLE 12.—CLAIMS FOR EXTRA COMPENSATION.

COAL COMPANY agrees that COAL COMPANY ENGINEER, in giving directions to CONTRACTOR, shall have authority to make minor changes in the work (excepting changes in the minimum stripping ratio hereinbefore described,) not involving extra cost to COAL COMPANY, and not inconsistent with the general purpose of the work, but the parties hereto mutually covenant and agree that no other changes in the work shall be made unless pursuant to a written order from COAL COMPANY authorizing the change, and stating the lump sum or unit prices to be paid for the same, and CONTRACTOR agrees that he will not make any claim for extra compensation based on any changes not so authorized in writing by COAL COMPANY.

[fol. 131] ARTICLE 13.—AMENDMENTS TO THIS CONTRACT.

No amendment to this contract shall be valid unless the same is made by an instrument in writing executed by COAL COMPANY and by CONTRACTOR, and in case of such amendment, so much of this contract as is not necessarily thereby changed shall remain in force; and no act or conduct of either party shall be held to operate as a waiver of any provision of this contract, unless in writing duly executed by the party against which it is asserted.

Method To Be Used.

ARTICLE 14.—PROCEDURE.

CONTRACTOR agrees to prosecute the work in a diligent, workmanlike manner, to the satisfaction of COAL COMPANY ENGINEER, and in accordance with the procedure and instructions set forth in the Contract Documents.

ARTICLE 15.—REMOVAL AND DISPOSAL OF OVERBURDEN.

CONTRACTOR agrees to remove and dispose of overburden and divider slate as directed by COAL COMPANY ENGINEER and in the manner described in the Specifications.

ARTICLE 16.—CLEANING OPENINGS IN COAL.

CONTRACTOR agrees to clean thoroughly all existing openings in coal and to keep the same free from all materials (other than coal) that may be precipitated into the workings within the limits of the stripping and mining project, all this to be done to the satisfaction of COAL COMPANY ENGINEER.

ARTICLE 17.—DEPOSITING COAL CUT.

CONTRACTOR agrees to pick out carefully, at his own expense, any coal which may be cut during the progress of the removal of overburden and divider slate and to deposit it at such points in the workings as may be designated by COAL COMPANY ENGINEER, this coal to be subsequently recovered during mining operations.

ARTICLE 18.—REMOVAL AND LOADING OUT OF COAL.

CONTRACTOR agrees to remove and load out the coal as directed by COAL COMPANY ENGINEER and in the manner described in the Specifications.

Equipment To Be Used.

ARTICLE 19.—SCHEDULE OF EQUIPMENT.

CONTRACTOR agrees to have at least the following equipment on the job, with competent and sufficient foremen, [fol. 132] operators, and laborers to operate same, and at work within the time specified after each item:—

Name, Type and Size of Equipment:	Equipment Will Be at Work on the Job Within Number of Days Indicated Subsequent to Date of This Contract
Power Shovels, Drills, Trucks and Miscellaneous Equipment	
Sufficient power shovels, well drills, trucks, tractors, pumps and other miscellaneous equipment to properly execute the work on this project	When required.

When Work Is to Be Done

Article 20.—Start of Operations.

Contractor agrees to enter upon the performance of said work within thirty (30) days after date of this Contract and to proceed with it continuously carrying it on at such points and in such order and at such times as he may from time to time be directed by Coal Company Engineer and in no case to proceed without first obtaining from Coal Company Engineer complete directions for the proper execution of work.

Article 21.—Rate of Removal of Overburden.

Contractor agrees, unless delayed by fires, strikes, floods or other unavoidable casualties, or by the written instructions of Coal Company, to remove the overburden and divider slate at such a rate that the coal production requirements as set forth in Article 22 shall at all times be attainable.

Article 22.—Schedule of Coal Extraction.

Contractor agrees, unless delayed by fires, strikes, floods or other unavoidable casualties, or by the written instructions of Coal Company, to produce, and to maintain the stripping and mining operations in condition to produce the maximum number of gross tons of raw coal obtainable per single seven (7) hour shift, beginning at a reasonable time after the date of this contract and continuing thereafter to completion of the project.

After completing the removal of coal by dipper shovel, Contractor shall install drag shovel equipment to recover,

to the satisfaction of COAL COMPANY ENGINEER, whatever coal that cannot be recovered by dipper shovel.

[fol. 133] ARTICLE 23.—SUSPENSION OF WORK.

(a) CONTRACTOR covenants and agrees that this contract may be entirely cancelled and terminated by COAL COMPANY, without incurring any liability whatsoever for so doing, at any time after CONTRACTOR has completed the stripping within the area and limits as to ratio set forth in Article 2. Such option to cancel and terminate entirely may be exercised by COAL COMPANY without specifying any reason therefor upon giving thirty (30) days written notice to CONTRACTOR of COAL COMPANY's intention so to cancel and terminate.

(b) CONTRACTOR further covenants and agrees that COAL COMPANY in any event shall have the option to entirely cancel and terminate this Contract at any time (prior to the completion of the stripping within the area and limits mentioned in the foregoing paragraph) by giving CONTRACTOR written notice of COAL COMPANY's intention so to do and then and in that event COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or other damages.

(c) CONTRACTOR further covenants and agrees that COAL COMPANY shall have the right to temporarily suspend work under this Contract at any time or times by giving CONTRACTOR written notice of COAL COMPANY's intention so to do. Should any such temporary suspension be made and continue for a period of five (5) weeks, except in case of strike or lockout, CONTRACTOR may notify COAL COMPANY in writing of CONTRACTOR's desire to cancel this contract and, if within thirty (30) days after receipt of said notice COAL COMPANY fails to give CONTRACTOR a written order to resume work, then CONTRACTOR may thereupon, by written notice served upon COAL COMPANY, forthwith cancel and terminate this contract. In the event of any such cancellation by CONTRACTOR, COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or other damages. If no such notice to cancel this contract has been given by CONTRACTOR and COAL COMPANY desires at

any time a resumption of the work under this Contract, it shall so notify CONTRACTOR, and upon receipt of such notice CONTRACTOR agrees that he will, within five (5) days thereafter, resume operation.

ARTICLE 24.—INTERRUPTION OF WORK.

It is the understanding of both parties that COAL COMPANY shall in no wise be held liable to CONTRACTOR for any interruptions or hindrance to the regular and continuous prosecution of the work to be performed by CONTRACTOR under the terms of this contract that may be caused by strikes of the workmen of COAL COMPANY, or through the interference of such workmen of COAL COMPANY with the workmen of CONTRACTOR, or that may be caused by any other occurrences beyond the control of COAL COMPANY.

[fol. 134] *Other Obligations of* CONTRACTOR.

ARTICLE 25.—TAXES; OLD AGE BENEFITS, WORKMEN'S COMPENSATION, UNEMPLOYMENT INSURANCE AND PUBLIC LIABILITY INSURANCE.

CONTRACTOR agrees that he and each of his subcontractors will deduct from the wages of his, its, or their employees and pay over to the proper authorities any tax or taxes as required by any State or Federal Laws and will comply with all State and Federal Laws relating to Old Age Benefits, Workmen's Compensation and Unemployment Insurance, including provision for the payment of Workmen's Compensation benefits to his employees or their dependents in accordance with the laws of the Commonwealth of Pennsylvania and all amendments thereto.

CONTRACTOR also agrees that he and each of his subcontractors shall carry a Public Liability Policy, with limits of at least $25,000 for any one person and $50,000 for any one accident. Before any of the employees of CONTRACTOR or employees of his subcontractors shall do any work upon the premises of COAL COMPANY, CONTRACTOR agrees to furnish COAL COMPANY with a certificate that such insurance coverage has been provided; said certificate to contain the date when the coverage expires. CONTRACTOR

agrees that the coverage shall not be cancelled until after all work required by this Contract is completed.

ARTICLE 26.—SURETY BOND.

If COAL COMPANY so requests, CONTRACTOR agrees to deliver to said COAL COMPANY, before the expiration of fifteen (15) days from the date of such request and, before any further payment hereunder shall become due from COAL COMPANY, a bond for the faithful performance of this Contract by CONTRACTOR in a form and in a penal sum satisfactory to COAL COMPANY executed by CONTRACTOR as principal and by a surety company satisfactory to COAL COMPANY as surety, the cost of said bond to be paid by COAL COMPANY.

ARTICLE 27.—PERMITS FROM PUBLIC AUTHORITIES.

CONTRACTOR agrees to obtain and pay for all permits from public authorities which may be required in connection with the performance of this contract, and to comply with all municipal and other public laws, ordinances, and requirements in regard to the same, and with all rules and regulations of any insurance companies which may have issued policies upon any part of the work or who may be asked to do so. CONTRACTOR also agrees to comply with the lawful orders of any public authority made from time to time in respect to the work to be done hereunder.

ARTICLE 28.—EMPLOYEES.

CONTRACTOR agrees to employ competent workmen and foremen, and immediately to discharge, whenever ordered to do so by COAL COMPANY, any person considered by COAL COMPANY incompetent, or disposed to be disorderly, and further agrees not again to employ such person upon the work.

[fol. 135] ARTICLE 29.—WATCHMEN.

It is the understanding of the parties hereto that COAL COMPANY shall not be responsible for the loss of or damage to the property of CONTRACTOR and/or his subcontractors (if any) from any cause. CONTRACTOR shall furnish what-

ever watchmen he finds necessary adequately to protect his interests.

ARTICLE 30.—PRECAUTIONS TO BE TAKEN BY CONTRACTOR.

CONTRACTOR agrees to use due care throughout the work, and that whenever the Specifications for any part of the work are, in his opinion, faulty, or at variance with any rules or ordinances applying to the work, or are such as will, if followed, result in unsafe conditions or will cause the work to result in pecuniary loss to COAL COMPANY or in any damage or loss to persons or property, he will instantly stop work on the portion affected thereby and immediately notify COAL COMPANY in writing of such opinion, and in what respect he considers said Specifications are faulty or at variance as aforesaid and CONTRACTOR will not proceed with the part of the work so affected until he has received a written order from COAL COMPANY ENGINEER directing what is to be done and when to proceed.

ARTICLE 31.—PROTECTION OF COAL COMPANY.

CONTRACTOR further covenants and agrees that he will indemnify and save harmless COAL COMPANY, its successors and assigns, of and from any loss, damage, cost, charge or expense, whether direct or indirect and whether to persons or property, to which COAL COMPANY, or its successors or assigns, may be subjected by any act, action, neglect or default on the part of CONTRACTOR or his subcontractors or any of CONTRACTOR'S or sub-contractors' officers, agents or employees.

If at any time during the progress of the work, CONTRACTOR shall allow any indebtedness to become due for labor, materials or services, whether said indebtedness may or may not become a lien or liens upon property of COAL COMPANY, or whether said indebtedness may or may not become a claim against COAL COMPANY, and shall permit said indebtedness to remain unpaid for a period of fifteen (15) days, CONTRACTOR shall immediately upon request from COAL COMPANY, pay the same, or cause the same to be secured by giving a bond, or otherwise, and in case of his failure so to do, COAL COMPANY, at its option, may with-

hold any money due CONTRACTOR until such indebtedness is paid or may apply such money towards the discharge thereof, or may forthwith terminate the employment of CONTRACTOR and proceed in accordance with the provisions of Article 47 hereof.

ARTICLE 32.—LIABILITY FOR DAMAGE TO OTHER CONTRACTORS.

If CONTRACTOR should cause damage to any other contractor on the stripping and mining operations, he agrees upon due notice to settle with such other contractor by agreement or arbitration. If any other contractor claiming damages sues COAL COMPANY on account of any damage alleged to have been sustained, COAL COMPANY shall notify CONTRACTOR who agrees to defend such proceedings at his [fol. 136] own expense. If any judgment against COAL COMPANY arises therefrom, CONTRACTOR agrees to pay or satisfy it and pay all costs incurred by COAL COMPANY.

ARTICLE 33.—SUBCONTRACTING AND ASSIGNING.

CONTRACTOR further covenants and agrees that he will not sell, assign, transfer or set over this contract or any part or interest therein to any person or persons whomsoever, without the consent in writing of COAL COMPANY, and any such sale, assignment or transfer, without such written consent from COAL COMPANY, shall be null and void. Any subcontracts entered into by CONTRACTOR shall be submitted to COAL COMPANY for approval and COAL COMPANY shall have the right to reject any subcontractor whom COAL COMPANY considers incompetent or unable satisfactorily to perform the portion of the work involved, and in that case such subcontractor shall do no work hereunder.

CONTRACTOR agrees to impose on the subcontractors under his charge the same responsibilities which CONTRACTOR assumes by these terms and conditions and the contract in general, and CONTRACTOR agrees that he will be fully responsible to COAL COMPANY for the acts and omissions of his subcontractors and of persons either directly or indirectly employed by all subcontractors.

ARTICLE 34.—LIENS.

No claim or mechanic's lien shall be filed by anyone against the tracts of ground upon which the stripping and mining operations are to be conducted or the buildings, machinery, or other "structure" (as defined by the Pennsylvania Mechanics Lien Act), erected thereon or any part thereof, whether so conducted, erected and constructed strictly in accordance with the provisions of the Contract Documents, or in accordance with any amendments thereof. CONTRACTOR shall execute in a form supplied by and acceptable to COAL COMPANY a separate agreement with COAL COMPANY to this effect so that the same may be duly filed.

ARTICLE 35.—COAL COMPANY'S OCCUPANCY OF PREMISES.

CONTRACTOR agrees that COAL COMPANY may, during the progress of the work, place and install or cause to be placed and installed within the area covered by these stripping and mining operations such other structures, equipment and materials and may carry on such other operations as it may deem desirable for its own purposes, before the completion of the various parts of the work, provided, however, that such use of portions of said area shall not substantially interfere with the work of CONTRACTOR, and CONTRACTOR further agrees that such placing and installation of structures, equipment and material shall not in any way evidence the completion of the work or any portion of it, nor shall be deemed or construed to signify COAL COMPANY's acceptance of the work or any part thereof.

[fol. 137] ARTICLE 36.—REMOVAL OF CONTRACTOR'S EQUIPMENT.

Upon the completion of the work to the satisfaction of COAL COMPANY, CONTRACTOR agrees to remove from the premises at his own expense all equipment, machinery and structures used by him in the said stripping and mining operations.

PART FOUR.—OBLIGATIONS OF COAL COMPANY

Prices To Be Paid for the Work.

Article 37.—Contract Price.

Coal Company hereby agrees to pay to Contractor as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the price of one dollar and seventy-five cents ($1.75) per gross ton as determined by scale weight in trucks of Contractor at Coal Company's Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents.

Article 38.—Stripping Work Wage Scale.

It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements and/or special or local agreements between the United Mine Workers of America and the Anthracite Operators of November 17, 1917, and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, January 9, 1943, and the National War Labor Board directive order dated October 28, 1943 and the memorandum of agreement between Messrs. Harold A. Ickes, Secretary of the Interior, and John L. Lewis, President of the United Mine Workers of America dated November 3, 1943 for this class of work in the Anthracite region.

In the event of an increase or decrease in the labor costs of Contractor by reason of an increase or decrease of the

labor wage scale, the contract price to be paid to CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR'S labor costs by reason of any such change in the labor wage scale.

In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit [fol. 138] COAL COMPANY to ascertain the amount of any increase or decrease in contractor's labor costs by reason of change in the labor wage scale, then and in that event COAL COMPANY shall specify what increase or decrease shall be made in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same.

Terms of Payment.

ARTICLE 39.—TIME AND METHOD OF PAYMENT.

The time and method of payment will be as follows:

CONTRACTOR will be paid on the regular stripping semi-monthly pay day schedule for each and every ton of raw coal that passes over the raw coal scale at COAL COMPANY'S Westwood Colliery during the period covered by the pay day schedule.

An amount equivalent to five cents (5¢) per ton of raw coal will be retained by COAL COMPANY from each semi-monthly estimate until the sum of twenty-five hundred dollars ($2500.00) will have accumulated, which sum will be held by COAL COMPANY until the completion of this Contract as a guarantee for the faithful performance by CONTRACTOR of this Contract.

Other Obligations of COAL COMPANY

ARTICLE 40.—

Blank.

ARTICLE 41.—

Blank.

ARTICLE 42.—

Blank.

ARTICLE 43.—

Blank.

ARTICLE 44.—PROVIDE DRAWINGS.

COAL COMPANY agrees to furnish to CONTRACTOR, free of charge, all copies of Drawings and Specifications reasonably necessary for the execution of the work.

It is the understanding of both parties that all drawings, specifications and copies thereof furnished by COAL COMPANY shall remain the property of COAL COMPANY. No part or all of these shall be used by CONTRACTOR on other work and, with the exception of the Specifications attached to CONTRACTOR's original copy of this Contract, they shall be returned to COAL COMPANY upon request upon termination of his work under this contract.

[fol. 139] ARTICLE 45.—SURVEYS, LINES AND GRADES.

COAL COMPANY ENGINEER will furnish surveys establishing with sufficient definiteness grade lines for the construction of all transportation and/or other facilities by CONTRACTOR.

ARTICLE 46.—TEMPORARY BUILDINGS.

COAL COMPANY agrees to permit CONTRACTOR to erect at his own expense at such points and places as COAL COMPANY ENGINEER shall designate for the purpose, such buildings as

may be necessary to carry on the work under this agreement, which buildings are to be removed by CONTRACTOR upon termination of his work done under this Contract. If CONTRACTOR fails to so remove said buildings, COAL COMPANY may do so at CONTRACTOR'S expense and CONTRACTOR agrees to immediately pay the same upon receipt of a bill therefore from COAL COMPANY, or COAL COMPANY may deduct such amount from sums then due and owing the CONTRACTOR by COAL COMPANY.

PART FIVE.—GENERAL PROVISIONS.

ARTICLE 47.—FORFEITURE OF CONTRACT.

In the event that CONTRACTOR should at any time refuse or neglect to supply a sufficient number of properly skilled workmen, plant, equipment or materials of the proper quantity or quality or fail in any respect to prosecute the work with sufficient promptness and diligence, or fail in the performance of any of the covenants and agreements herein contained, such refusal, neglect or failure being certified by COAL COMPANY ENGINEER, COAL COMPANY shall be at liberty, after three days' written notice to CONTRACTOR, to provide any such labor, plant, equipment or materials, and to deduct the cost thereof from any money then due or thereafter to become due to CONTRACTOR under this contract; and if said COAL COMPANY ENGINEER shall certify that such refusal, neglect or failure is sufficient ground for such action, COAL COMPANY shall also be at liberty to terminate the employment of CONTRACTOR for the said work and to enter upon the premises and take possession, for the purpose of completing the work included under this contract, of all plant, equipment, materials, tools, and appliances thereon, and to employ any other person or persons to finish the work, and to provide the materials therefore; and in case of such discontinuance of the employment of CONTRACTOR he shall not be entitled to receive any further payment under this contract until the said work shall be wholly finished, at which time, if the unpaid balance of the amount to be paid under this contract shall exceed the expense incurred by COAL COMPANY in finishing the work, such excess shall be paid by COAL COMPANY to CONTRACTOR.

But if such expense shall exceed such unpaid balance, CONTRACTOR shall pay the difference to COAL COMPANY. The expense incurred by COAL COMPANY as herein provided, either for furnishing materials or for finishing the work, and any damage incurred through such default, shall be audited and certified by the Treasurer of COAL COMPANY whose certificate thereof shall be conclusive upon the parties unless objected to in writing within ten days from certification and service. In case an objection to the certificate [fol. 140] of the Treasurer shall be filed within the time specified as aforesaid, the accuracy of the said certificate shall be determined by arbitration.

ARTICLE 48.—ARBITRATION.

Whenever under any of the provisions of this Contract it is provided that any question shall be determined by arbitration at the instance of either COAL COMPANY or CONTRACTOR, the question at the time in dispute shall be determined by three arbitrators selected or appointed as hereinafter provided. The party desiring arbitration shall give written notice to the other party setting forth in general terms the question or questions to be arbitrated and determined and the section or sections of this Contract under which the right of arbitration arises, and in said notice shall appoint an arbitrator. Within ten days thereafter the party so notified shall appoint in writing an arbitrator and shall give written notice of such appointment to the party desiring arbitration; but if within said ten days the said arbitrator is not so appointed and notified to the party desiring arbitration, then the party desiring arbitration may make application to the then President of The Fidelity-Philadelphia Trust Company of Philadelphia for the appointment of such arbitrator; and it is hereby agreed that the said President may appoint such arbitrator. The first arbitrator and the second arbitrator so appointed shall, within ten days after the appointment of the latter, select a third arbitrator, but if they shall fail so to do within said period of ten days, either party may make application to the then President of The Fidelity-Philadelphia Trust Company of Philadelphia for the appointment of a

third arbitrator, and it is hereby agreed that the said President may appoint such arbitrator. The decision of a majority of the three arbitrators so appointed and selected shall be final, binding and conclusive upon both parties hereto without any right of appeal therefrom to any Court, except such as is provided for in the Act of Assembly of the Commonwealth of Pennsylvania approved April 25, 1927, P. L. 381. Each party shall bear its own cost and expense of arbitration. The costs and expenses incurred by the arbitrators, including their reasonable compensation, shall be paid in equal shares by COAL COMPANY and CONTRACTOR.

The provisions of the said Act of Assembly of the Commonwealth of Pennsylvania, as the same may be amended and supplemented from time to time, shall be applicable to the arbitration herein provided for.

ARTICLE 49.—PREVIOUS COMMUNICATIONS.

All previous communications between the parties hereto, either verbal or written, are hereby abrogated and withdrawn, and this contract with the Specifications referred to herein constitutes the whole agreement between the parties hereto.

[fol. 141] IN WITNESS WHEREOF, the parties to this agreement have hereunto set their hands and seals as of the day and year first above written.

Signed, sealed and delivered
in the presence of us:

/s/ Jos. W. CHAMBERLAIN /s/ GEORGE W. HUSS (SEAL)
George W. Huss

/s/ Jos. W. CHAMBERLAIN /s/ RUSSELL N. HUSS (SEAL)
Russell N. Huss

/s/ Jos. W. CHAMBERLAIN /s/ WESLEY W. HUSS (SEAL)
Wesley W. Huss

Partners, Trading and Doing Business
as GEORGE W. HUSS CONTRACTING COMPANY,
a Partnership.

CONTRACTOR.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY (SEAL)

By /s/ R. E. TAGGART
President

Attest: /s/ M. P. McDERMOTT
Secretary

COAL COMPANY

[fol. 143]

SPECIFICATIONS

OUTLINE

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[fol. 144]

SPECIFICATIONS
FOR

STRIPPING AND MINING THE VARIOUS VEINS ON THE NORTH AND SOUTH DIPS AT TOWER CITY SECTION, IN AREAS DESIGNATED BY THE COAL COMPANY ENGINEER—STRIPPING NO. P-22

The Philadelphia and Reading Coal and Iron Company,
Pottsville, Pennsylvania.

I.—GENERAL.

This Specification and Drawings listed hereinunder are a part of the "Contract Documents" which shall apply in full and in part.

II.—DRAWINGS.

The drawings above referred to are the mine maps of the COAL COMPANY that are available for reference in the COAL COMPANY'S office.

III.—DESCRIPTION OF PROJECT.

The work covered by this specification includes the performance of all work and the furnishing and paying for all the material, labor, tools, equipment, water, light, power, transportation and other facilities, unless specified otherwise, hereinafter, required for the excavation, removal and disposal of all overburden materials and divider slate lying over, between and/or in the veins of coal and for mining, transporting to and delivery into the raw coal chute at Westwood Breaker of all the raw coal that is recoverable by stripping in the area designated by COAL COMPANY ENGINEER and within the limits set forth by said COAL COMPANY ENGINEER, all the above to be done in accordance with the Contract Documents referred to herein.

IV.—LOCATION AND LIMITS OF PROJECT.

It is the understanding of the parties hereto that the project referred to above is the stripping areas in the various veins on the North and South Dips at the Tower City Section, as designated by the COAL COMPANY ENGINEER and located on the Munson and Williams Lands, Porter Township, Schuylkill County, Pennsylvania, which lands are owned by COAL COMPANY.

It is further understood by the parties hereto that the minimum acceptable stripping ratio shall be an average for the entire project of four (4.0) place cubic yards of overburden per gross ton of raw coal recovered.

[fol. 145] V.—PROCEDURE.

CONTRACTOR shall conduct stripping and mining operations on the project in a manner which will permit producing coal at the rate and under the conditions described in Article 22 of the Contract.

VI.—OVERBURDEN DISPOSAL.

CONTRACTOR will comply with instructions from COAL COMPANY ENGINEER regarding the disposal of overburden.

VII.—REMOVAL OF SURFACE REFUSE.

All surface stone, dirt and clay washed into the stripping pits must be kept out of the coal loaded by CONTRACTOR at his own expense.

VIII.—REFUSE IN RAW COAL.

CONTRACTOR shall so conduct stripping and mining operations as to keep at a minimum "extraneous refuse" loaded with the coal, and he agrees to be controlled in this matter by the instructions of COAL COMPANY ENGINEER, and to be bound by his decision.

IX.—POINT OF DELIVERY OF COAL.

CONTRACTOR will deliver and dump the raw coal into the raw coal chute at Westwood Breaker owned by COAL COMPANY and located at Westwood Colliery.

X.—RAW COAL CHUTE AT WESTWOOD BREAKER.

COAL COMPANY agrees to permit CONTRACTOR to enter upon COAL COMPANY premises for delivery of raw coal to the raw coal chute at Westwood Breaker.

XI.—OTHER PROVISIONS.

(a) Power

CONTRACTOR shall, at his own expense, provide all power required for operation of the project.

(b) Water

CONTRACTOR shall, at his own expense, provide all water required for operation of the project.

(c) Roads and Track

CONTRACTOR shall, at his own expense, provide all roads and/or tracks required for the handling, removal and dis-

posal of overburden and coal, and for delivery of raw coal to the raw coal chute at Westwood Breaker.

[fol. 146] *(d) Outlet Cuts*

CONTRACTOR shall, at his own expense, provide all outlet cuts required for the handling, removal and disposal of overburden and coal, and for delivery of raw coal mined to the raw coal chute at Westwood Breaker.

(e) Railroad Siding

The Reading Railroad spur tracks at Good Spring are at present available to the CONTRACTOR for bringing to the project all equipment and materials required for the completion of the work on the project.

CONTRACTOR shall provide all facilities and labor to unload and store all his own material, apparatus and equipment, and shall be entirely responsible for same.

Less-than-carload shipments shall be handled through the nearest local railroad freight house, and CONTRACTOR shall arrange for the delivery of such shipments to the location of his job.

[fol. 148] MINE MAPS AND CROSS SECTIONS OF THE TOWER CITY SECTION ARE AVAILABLE FOR REFERENCE IN THE OFFICE OF THE COAL COMPANY ENGINEER, POTTSVILLE, PA.

[fol. 150]

IN THE COURT OF COMMON PLEAS,

COUNTY OF SCHUYLKILL.

No. ....., ... Term, 19....

MECHANICS LIEN DOCKET No. .....

THE PHILADELPHIA AND READING COAL AND IRON COMPANY, (COAL COMPANY)

v.

GEORGE W. HUSS CONTRACTING COMPANY (CONTRACTOR)

STIPULATION AGAINST LIENS.

WHEREAS, on the 27th day of May, 1944 a contract was entered into between THE PHILADELPHIA AND READING COAL AND IRON COMPANY, a Corporation of the State of Pennsylvania (hereinafter called "COAL COMPANY") and GEORGE W. HUSS, RUSSELL N. HUSS AND WESLEY W. HUSS, Partners, trading and doing business as GEORGE W. HUSS CONTRACTING COMPANY, a Partnership operating in the State of Pennsylvania (hereinafter called "CONTRACTOR") wherein and whereby said CONTRACTOR undertook and agreed to perform certain stripping and mining operations in the various veins on the North and South Dips at the Tower City Section in areas designated by the COAL COMPANY ENGINEER, and to erect and construct certain buildings (if necessary) and other structures (as defined by the Pennsylvania Mechanics Lien Act) hereinafter generally referred to as "structures" upon parts or all of certain tract of ground in Porter Township, Schuylkill County, Pennsylvania, known as the Munson and Williams Lands, which lands are owned by COAL COMPANY; the raw coal chute at Westwood Breaker is located on the John Lesher Tract;

with respect to all of which said COAL COMPANY is the owner.

NOW, THEREFORE, THIS AGREEMENT WITNESSETH, that for and in consideration of the sum on one dollar ($1.00) to

said CONTRACTOR in hand paid by said COAL COMPANY, the receipt whereof is hereby acknowledged, and the further consideration mentioned in the contract aforesaid, said CONTRACTOR, for itself, himself and/or themselves and for its, his or their subcontractors and all parties acting through or under it, him, them or any of them, hereby covenants and agrees that no mechanics' claims or liens shall be filed or maintained by it, him, them or any of them, against the said structures and the lot of ground appurtenant thereto, or any of them, for or on account of any work done or materials or labor furnished by it, him, them or any of them, under said agreement or otherwise, for, towards, in or about the construction and erection of the said structure or structures, or any of them, and the said CONTRACTOR, for itself, himself and/or themselves and for [fol. 151] its, his or their subcontractors, and others under it, him or them, hereby expressly waives and relinquishes the right to have, file or maintain any mechanic's lien or claim against the said structures, or any of them, and agrees that this agreement waiving the right of lien shall be an independent covenant.

WITNESS our hands and seals this 27th day of May, 1944.

Signed, sealed and delivered
in the presence of:

/s/ Jos. W. CHAMBERLAIN /s/ GEORGE W. HUSS (SEAL)
George W. Huss

/s/ Jos. W. CHAMBERLAIN /s/ RUSSELL N. HUSS (SEAL)
Russell N. Huss

/s/ Jos. W. CHAMBERLAIN /s/ WESLEY W. HUSS (SEAL)
Wesley W. Huss

Partners, Trading and Doing Business
as GEORGE W. HUSS CONTRACTING COMPANY
a Partnership.

CONTRACTOR.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY (SEAL)

By /s/ R. E. TAGGART
President

Attest: /s/ M. P. McDERMOTT
Secretary

COAL COMPANY.

[fol. 152]

The PHILADELPHIA *and* READING COAL *and* IRON COMPANY

READING TERMINAL

[Emblem]

PHILADELPHIA 5, PA.

POTTSVILLE, PA.
August 22, 1945.

Geo. W. Huss Contracting Company,
Centralia, Penna.

Gentlemen:—

We send you, herewith, for your record and file, an executed copy of the Supplemental Agreement dated August 20, 1945, covering changes to Articles 37 and 38 of the contract for Tower City Stripping No. P-22, between yourselves and this company.

Very truly yours,

/s/ WM. C. MUEHLHOF
Wm. C. Muehlhof
CHIEF ENGINEER.

M/r
cc-GAR
GJC
CHK

[fol. 153] SUPPLEMENTAL AGREEMENT

WITNESS: THIS SUPPLEMENTAL AGREEMENT made this 20th day of August in the year 1945 between GEORGE W. HUSS, RUSSELL N. HUSS and WESLEY W. HUSS, trading and doing business as GEORGE W. HUSS CONTRACTING COMPANY, a Partnership, operating in the Commonwealth of Pennsylvania (hereinafter referred to as "CONTRACTOR"), party of the first part, and THE PHILADELPHIA AND READING COAL AND IRON COMPANY, a Corporation of the Commonwealth of Pennsylvania (hereinafter referred to as "COAL COMPANY"), party of the second part,

WHEREAS, under date of May 27, 1944, COAL COMPANY and CONTRACTOR executed an Agreement covering the so-called Stripping No. P-22, and

WHEREAS, Article 37 and Article 38 of said Agreement dated May 27, 1944, provide as follows:

ARTICLE 37.—CONTRACT PRICE.

"COAL COMPANY hereby agrees to pay to CONTRACTOR as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the price of one dollar and seventy-five cents ($1.75) per gross ton as determined by scale weight in trucks of CONTRACTOR at COAL COMPANY's Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents."

ARTICLE 38.—STRIPPING WORK WAGE SCALE.

"It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements and/or special or local agreements between the United Mine Workers of America and the Anthracite Operators of November 17, 1917, and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, January 9, 1943, and the National War Labor Board directive order dated October 28, 1943 and the memorandum of agreement between Messrs. Harold A. Ickes, Secretary of the Interior, and John L. Lewis, President of the United Mine Workers of America dated November 3, 1943 for this class of work in the [fol. 154] Anthracite region.

"In the event of an increase or decrease in the labor costs of CONTRACTOR by reason of an increase or decrease of the labor wage scale, the contract price to be paid to CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

"CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR's labor costs by reason of any such change in the labor wage scale.

"In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit COAL COMPANY to ascertain the amount of any increase or decrease in CONTRACTOR's labor costs by reason of change in the labor wage scale, then and in that event COAL COMPANY shall specify what increase or decrease shall be made in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same."

And Whereas, due to the Wage Agreement of May 19, 1945, between the United Mine Workers of America and the Anthracite Operators, it is desired to amend said Article 37 and Article 38 of said agreement,

Now, Therefore, it is mutually agreed that Article 37 and Article 38 of said agreement are, effective May 1, 1945, amended to read and provide as follows:-

Article 37.—Contract Price.

Coal Company hereby agrees to pay to Contractor as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also, for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the [fol. 155] price of one dollar and eighty-five cents ($1.85) per gross ton as determined by scale weight in trucks of Contractor at Coal Company's Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents.

Article 38.—Stripping Work Wage Scale.

It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements between the United Mine Workers of America and the Anthracite Operators of November 17, 1917 and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, January 9, 1943, March 8, 1944, and May 19, 1945; and/or special or local wage

agreements between the United Mine Workers of America and the Stripping Contractors in District 9, covering shovel operators, dated June 11, 1940 and July 15, 1944, for this class of work in the Anthracite region.

In the event of an increase or decrease in the labor costs of CONTRACTOR by reason of an increase or decrease of the labor wage scale, and/or a resumption of a five day work week instead of a six day work week, the contract price to be paid CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR's labor costs by reason of any such change in the labor wage scale.

In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit COAL COMPANY to ascertain the amount of any increase or decrease in CONTRACTOR's labor costs by reason of change in the labor wage scale, then and in that event COAL COMPANY shall specify what increase or decrease shall be made in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same.

It is further agreed that, with the exception of the amendments of Article 37 and Article 38 of said Agreement dated May 27, 1944, each and every covenant, condition, stipula- [fol. 156] tion and requirement, embodied and contained in the said Agreement dated May 27, 1944 covering the so-called Stripping No. P-22, shall remain in full force and effect as though these presents had not been executed.

In Witness Whereof, the parties of the first part have hereunto set their hands and seals and the party of the second part has hereunto affixed its corporate seal duly attested the day and year first above written.

Witness:

/s/ Joseph Chamberlain /s/ George W. Huss (Seal)
George W. Huss

/s/ Joseph Chamberlain /s/ Russell N. Huss (Seal)
Russell N. Huss

/s/ Joseph Chamberlain /s/ Wesley W. Huss (Seal)
Wesley W. Huss

Partners, Trading and Doing Business as George W. Huss

Contracting Company, a Partnership.

Contractor.

The Philadelphia and Reading Coal and Iron Company (Seal)

By /s/ R. E. Taggart
President

Attest: /s/ M. P. McDermott
Secretary

Coal Company.

[fol. 157] Cancellation of Agreement

In consideration of the sum of one dollar ($1.00), to each in hand paid, and other good and valuable considerations, the receipt of which is hereby acknowledged, it is hereby mutually agreed that the Agreement dated May 27, 1944 between the parties hereto for Stripping and Mining the Various Veins on the North and South Dips at the Tower City Section in Areas designated by the Coal Company Engineer—Stripping No. P-22, and Supplemental Agreements dated August 20, 1945 and October 28, 1946,

be cancelled and annulled, and that all and singular the rights and obligations secured and imposed thereby be terminated as of July 31, 1947.

In Witness Whereof, and intending to be legally bound, the parties to this ag eement have hereunto set their hands and seals this 31st day of October, 1947.

Witness:

/s/ Weller Hunsinger — /s/ George W. Huss (Seal)
George W. Huss

/s/ Weller Hunsinger — /s/ Russell N. Huss (Seal)
Russell N. Huss

/s/ Weller Hunsinger — /s/ Wesley W. Huss (Seal)

Partners, Trading and Doing Business as George W. Huss Contracting Company, a Partnership.

Contractor.

The Philadelphia and Reading Coal and Iron Company (Seal)

By /s/ R. E. Taggart
President

Attest: /s/ Howard Price
Secretary

Coal Company.

[fol. 158] Supplemental Agreement No. 2

Witness This Supplemental Agreement No. 2 made this 28th day of October in the year 1946 between George W. Huss, Russell N. Huss and Wesley W. Huss, trading and doing business as George W. Huss Contracting Company, a Partnership, operating in the Commonwealth of Pennsylvania (hereinafter referred to as "Contractor"), party of the first part, and The Philadelphia and Read-

ING COAL AND IRON COMPANY, a Corporation of the Commonwealth of Pennsylvania (hereinafter referred to as "COAL COMPANY"), party of the second part,

WHEREAS, under date of May 27, 1944, COAL COMPANY and CONTRACTOR executed an Agreement covering the so-called Stripping No. P-22, and

WHEREAS, under date of August 20, 1945, COAL COMPANY and CONTRACTOR executed a Supplemental Agreement amending Article 37 and Article 38 of said Agreement dated May 27, 1944 to provide as follows:

ARTICLE 37.—CONTRACT PRICE.

"COAL COMPANY hereby agrees to pay to CONTRACTOR as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the price of one dollar and eighty-five cents ($1.85) per gross ton as determined by scale weight in trucks of CONTRACTOR at COAL COMPANY'S Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents."

ARTICLE 38.—STRIPPING WORK WAGE SCALE.

"It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements between the United Mine Workers of America and the Anthracite Operators of No-

vember 17, 1917, and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, January 9, 1943, March 8, 1944, and May 19, 1945; and/or special or local wage agreements between the United Mine Workers of America and the Stripping Contractors in District 9, covering shovel operators, dated June 11, 1940 and July 15, 1944, [fol. 159] for this class of work in the Anthracite region.

"In the event of an increase or decrease in the labor costs of CONTRACTOR by reason of an increase or decrease of the labor wage scale, and/or a resumption of a five day work week instead of a six day work week, the contract price to be paid CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

"CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR'S labor costs by reason of any such change in the labor wage scale.

"In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit COAL COMPANY to ascertain the amount of any increase or decrease in CONTRACTOR'S labor costs by reason of change in the labor wage scale, then and in that event COAL COMPANY shall specify what increase or decrease shall be made in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same."

AND WHEREAS, due to the Wage Agreement of June 7, 1946, between the United Mine Workers of America and

the Anthracite Operators, it is desired to amend said Article 37 and Article 38 of said Supplemental Agreement dated August 20, 1945,

Now, Therefore, it is mutually agreed that Article 37 and Article 38 of said Supplemental Agreement dated August 20, 1945, are, effective June 1, 1946, further amended to read and provide as follows:—

Article 37.—Contract Price.

Coal Company hereby agrees to pay to Contractor as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also, for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected [fol. 160] therewith, the price of two dollars ($2.00) per gross ton as determined by scale weight in trucks of Contractor at Coal Company's Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents.

Article 38.—Stripping Work Wage Scale

It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements between the United Mine Workers of America and the Anthracite Operators of November 17, 1917 and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, March 8, 1944, May 19, 1945, and June 7, 1946; and/or special or local wage agreements between

the United Mine Workers of America and the Stripping contractors in District 9, covering shovel operators, dated June 11, 1940 and July 15, 1944, for this class of work in the Anthracite region.

In the event of an increase or decrease in the labor costs of CONTRACTOR by reason of an increase or decrease of the labor wage scale, and/or a resumption of a five-day work week instead of a six-day work week, the contract price to be paid CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR'S labor costs by reason of any such change in the labor wage scale.

In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit COAL COMPANY to ascertain the amount of any increase or decrease in CONTRACTOR'S labor costs by reason of change in the labor wage scale, then and in that event COAL COMPANY shall specify what increase or decrease shall be made in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same.

It is further agreed that, with the exception of the further amendments of Article 37 and Article 38 of said Agreement dated May 27, 1944, each and every covenant, condition, stipulation and requirement, embodied and contained in the said Agreement dated May 27, 1944, covering the so-called Stripping No. P-22, shall remain in full force and effect as though these presents had not been executed.

[fol. 161] IN WITNESS WHEREOF, the parties of the first part have hereunto set their hands and seals and the party

of the second part has hereunto affixed its corporate seal duly attested the day and year first above written.

WITNESS:

/s/ JOSEPH CHAMBERLAIN /s/ GEORGE W. HUSS (Seal)
George W. Huss

/s/ JOSEPH CHAMBERLAIN /s/ RUSSELL N. HUSS (Seal)
Russell N. Huss

/s/ JOSEPH CHAMBERLAIN /s/ WESLEY W. HUSS (Seal)
Wesley W. Huss

Trading and Doing Business as
GEORGE W. HUSS CONTRACTING
COMPANY, a Partnership.

CONTRACTOR.

THE PHILADELPHIA AND READING
COAL AND IRON COMPANY (Seal)

By /s/ R. E. TAGGART
President

Attest: HOWARD PRICE
Secretary

COAL COMPANY.

[fol. 162]

EXHIBIT A

CONTRACT
SPECIFICATIONS
DRAWINGS
STIPULATION AGAINST LIENS

FOR

STRIPPING AND MINING THE VARIOUS VEINS ON THE NORTH AND SOUTH DIPS AT THE TOWER CITY SECTION IN AREAS DESIGNATED BY COAL COMPANY'S ENGINEER—STRIPPING NO. P-22B.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY, POTTSVILLE, PENNSYLVANIA.

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[fol. 166]

THE PHILADELPHIA AND READING COAL AND IRON COMPANY

Pottsville, Pennsylvania

Contract

for

Stripping and Mining the Various Veins on the North and South Dips at the Tower City Section in Areas Designated by the Coal Company's Engineer-Stripping No. P-22B

This memorandum of agreement, made and entered into this 23rd day of February in the year 1945, between George W. Huss, Russell N. Huss and Wesley W. Huss, Partners, trading and doing business as George W. Huss Contracting Company, a Partnership operating in the Commonwealth of Pennsylvania (hereinafter referred to as "Contractor"), party of the first part, and The Philadelphia and Reading Coal and Iron Company, a corporation of the Commonwealth of Pennsylvania (hereinafter referred to as "Coal Company"), party of the second part,

Witnesseth: That for and in consideration of the mutual agreements herein contained, it is agreed by and between the parties hereto, for themselves, their successors, heirs, executors, administrators and assigns as follows:—

PART ONE.—GENERAL

Article 1.—Description of Project.

It is the understanding of the parties hereto that this project is a "salvage stripping" operation. Contractor agrees to assume all risk connected with the prospecting, discovery and recovery of all the coal that is recoverable by stripping in the areas designated by the Coal Company's Engineer.

Contractor does also hereby covenant, promise and agree, for the consideration hereinafter named, to do all

work and provide all the material, labor, tools, equipment, water, light, power, transportation and other facilities, unless specified otherwise hereinafter, required for the excavation, removal and disposal of all overburden material and divider slate lying over, between and/or in the veins of coal and for mining, transporting, and delivery into the raw coal chute at Westwood Breaker of all the raw coal that is recoverable by stripping within the areas designated by COAL COMPANY'S ENGINEER and within the limits set forth by said COAL COMPANY'S ENGINEER, all the above to be done in accordance with the Contract Documents referred to herein and hereto attached, and under the direction and to the satisfaction of COAL COMPANY'S ENGINEER.

[fol. 167] ARTICLE 2.—LOCATION AND LIMITS OF PROJECT.

It is the understanding of the parties hereto that the project referred to above is the stripping areas in the various veins on the North and South Dips at the Tower City Section, as designated by the COAL COMPANY'S ENGINEER, and located on the Swatara Coal Company Lands and Munson and Williams Lands, Porter Township, Schuylkill County, Pennsylvania, which lands are owned by COAL COMPANY.

It is further understood by the parties hereto that the minimum acceptable stripping ratio shall be an average for the entire project of four (4.0) place cubic yards of overburden per gross ton of raw coal recovered.

PART TWO.—PRELIMINARY CONSIDERATIONS.

ARTICLE 3.—CONTRACTOR'S FAMILIARITY WITH PROJECT.

It is the understanding of the parties hereto that CONTRACTOR has carefully examined all data available concerning the stripping area, has visited the site, has fully informed himself as to all existing conditions and limitations including all laws, ordinances and regulations affecting the contract or the work and has included in the bid price a sum sufficient to cover the cost of all items implied or

required to attain the completed conditions contemplated by the contract.

It is further understood that CONTRACTOR has familiarized himself with the features and details of the project insofar as they may tie in with his work.

Failure to have complied with the above shall not relieve CONTRACTOR of any of the obligations of the contract.

ARTICLE 4.—CONTRACT DOCUMENTS.

The Contract Documents consist of the following parts and each is as fully a part of this contract as if herein inserted at length:

CONTRACT.
SPECIFICATIONS.
DRAWINGS.
STIPULATION AGAINST LIENS.

These documents are together the documents governing in the execution of this contract and are hereinafter referred to collectively as the "Contract Documents".

The Contract Documents shall be signed in triplicate by COAL COMPANY and CONTRACTOR. In case of failure to sign the Specifications, COAL COMPANY shall identify them.

[fol. 168] ARTICLE 5.—DEFINITION OF TERMS.

The term "raw coal" as used herein shall mean the mixture of coal, divider slate and extraneous refuse as it is taken from the stripping.

The term "salvage stripping" as used herein shall be deemed to mean a project wherein COAL COMPANY reserves a coal-bearing area for CONTRACTOR, gives CONTRACTOR permission to enter upon this area and strip it, and agrees to pay CONTRACTOR a specified amount of money for each ton of raw coal that CONTRACTOR delivers to COAL COMPANY at a point and under certain conditions specified by COAL COMPANY. In a "salvage stripping" project COAL COMPANY assumes no responsibility for the discovery of coal, gives CONTRACTOR no guarantee of the quantity of coal in the

stripping area and places upon CONTRACTOR all risk in connection with the prospecting, discovery and recovery of coal and the operation of the entire stripping project.

The term "raw coal chute" at Westwood Breaker as used herein shall mean the structure located at Westwood Colliery and is of a suitable design to permit the dumping of the raw coal as contained in the trucks of CONTRACTOR.

"COAL COMPANY'S ENGINEER" referred to in the Contract Documents is the Division Engineer (or his authorized representative) of COAL COMPANY'S Operating Division of which the stripping and mining project covered herein is a part.

The term "subcontractor", as employed in the Contract Documents, includes only those having a direct contract with CONTRACTOR.

"Written Notice" shall be deemed to have been duly served if delivered in person to CONTRACTOR, or to a member of the firm, or to an officer of the corporation for whom it is intended, or if delivered or sent by registered mail, to the addressee at the last business address known to him who gives the notice.

The term "Cubic Yard" as employed in the Contract Documents with reference to overburden is the volume of the overburden material as it exists in place before the start of the proposed work.

The term "Drawings" as employed in the Contract Documents shall be deemed to include all plans, sections, maps, blue prints, photostats, sketches and other similar documents, whether general or detail.

The term "Ton" as employed in the Contract Documents, shall be deemed to mean a gross ton of 2240 pounds.

The term "Overburden" as employed in the Contract Documents, shall be deemed to mean all materials, other than "Divider Slate" and acceptable coal, which it is necessary to excavate, handle, remove and/or dispose of in the course of the work covered by this Contract.

[fol. 169] The term "Extraneous Refuse" as employed in the Contract Documents, shall be deemed to mean material originating outside of the vein or veins or within the vein or veins in the form of major partings which are of such

nature and thickness as can, in the opinion of COAL COMPANY'S ENGINEER, be removed separately from the coal by power shovel.

The term "Divider Slate" as employed in the Contract Documents, shall be deemed to mean any slate, rock or other material (other than acceptable coal) which may be found to exist within the limit of the coal vein or veins included within this stripping and mining operation.

All time limits stated in the Contract Documents are of the essence of the contract.

Article, Section and Paragraph headings and titles are for convenience of reference only, and shall not be construed to affect in any manner the scope or meaning of any article, section or paragraph of this contract.

Throughout the Contract Documents, COAL COMPANY is referred to as neuter gender and singular number and CONTRACTOR as masculine gender and singular number.

ARTICLE 6.—CONTRACT, SPECIFICATIONS AND DRAWINGS.

CONTRACTOR agrees that the drawings referred to in the Specifications shall be deemed a part of the Contract and that this Contract, the Specifications and Drawings, are to be considered together in the execution of the Contract.

ARTICLE 7.—SUFFICIENCY OF SPECIFICATIONS.

CONTRACTOR admits that the Specifications are sufficient for their intended purpose; the purpose of the Specifications being to describe the stripping areas and set forth other conditions that CONTRACTOR must fulfill on the project; CONTRACTOR further covenants and agrees to be governed in each case by detail specifications which are to be deemed a part of the Specifications referred to herein and made a part hereof, although said detail Specifications may not be prepared until after the commencement of said work.

ARTICLE 8.—DIRECTION OF WORK PERFORMED.

CONTRACTOR agrees to perform all work hereunder in accordance with directions that may from time to time be given to CONTRACTOR by COAL COMPANY'S ENGINEER.

[fol. 170] PART THREE.—OBLIGATIONS OF CONTRACTOR

Work To Be Done

ARTICLE 9.—WORK TO BE DONE BY CONTRACTOR.

CONTRACTOR agrees to perform all work required for the prospecting, discovery and recovery of all coal; the removal of overburden; and for the delivery of raw coal into the Raw Coal Chute at Westwood Breaker located at Westwood Colliery and owned by COAL COMPANY; all the above to be done to the extent and under conditions described in the Contract Documents.

ARTICLE 10.—ITEMS TO BE PROVIDED BY CONTRACTOR.

Unless otherwise stipulated, CONTRACTOR agrees to provide and pay for all materials, labor, tools, equipment, water, light, power, transportation and other facilities necessary for the execution and completion of the work. Materials or work described in words which so applied have a well-known technical or trade meaning shall be held to refer to such recognized standards.

ARTICLE 11.—DETERMINATION OF SCOPE OF WORK.

The term "Scope of Work" as used herein is understood by the parties hereto to refer to everything required to extract, process and deliver into the raw coal chute at Westwood Breaker, all of the raw coal that is recoverable by stripping within the areas of the project described in Articles 1 and 2.

It is the understanding of the parties hereto that the Scope of Work will be determined and controlled by the actual conditions found to prevail with respect to the project and that these conditions must be ascertained by prospecting and proving to be done by the CONTRACTOR at his expense and under the direction of the COAL COMPANY'S ENGINEER.

ARTICLE 12.—CLAIMS FOR EXTRA COMPENSATION.

COAL COMPANY agrees that COAL COMPANY'S ENGINEER, in giving directions to CONTRACTOR, shall have authority to make minor changes in the work (excepting changes in the minimum stripping ratio hereinbefore described), not involving extra cost to COAL COMPANY, and not inconsistent with the general purpose of the work, but the parties hereto mutually covenant and agree that no other changes in the work shall be made unless pursuant to a written order from COAL COMPANY authorizing the change, and stating the lump sum or unit prices to be paid for the same, and CONTRACTOR agrees that he will not make any claim for extra compensation based on any changes not so authorized in writing by COAL COMPANY.

[fol. 171] ARTICLE 13.—AMENDMENTS TO THIS CONTRACT.

No amendment to this contract shall be valid unless the same is made by an instrument in writing executed by COAL COMPANY and by CONTRACTOR, and in case of such amendment, so much of this contract as is not necessarily thereby changed shall remain in force; and no act or conduct of either party shall be held to operate as a waiver of any provision of this contract, unless in writing duly executed by the party against which it is asserted.

Method To Be Used

ARTICLE 14.—PROCEDURE.

CONTRACTOR agrees to prosecute the work in a diligent, workmanlike manner, to the satisfaction of COAL COMPANY'S ENGINEER, and in accordance with the procedure and instructions set forth in the Contract Documents.

ARTICLE 15.—REMOVAL AND DISPOSAL OF OVERBURDEN.

CONTRACTOR agrees to remove and dispose of overburden and divider slate as provided in the Specifications.

ARTICLE 16.—CLEANING OPENINGS IN COAL.

CONTRACTOR agrees to clean thoroughly all existing openings in coal and to keep the same free from all materials (other than coal) that may be precipitated into the workings within the limits of the stripping and mining project, all this to be done to the satisfaction of COAL COMPANY'S ENGINEER.

ARTICLE 17.—DEPOSITING COAL CUT.

CONTRACTOR agrees to pick out carefully, at his own expense, any coal which may be cut during the progress of the removal of overburden and divider slate and to deposit it at such points in the workings as may be designated by COAL COMPANY'S ENGINEER, this coal to be subsequently recovered during mining operations.

ARTICLE 18.—REMOVAL AND LOADING OUT OF COAL.

CONTRACTOR agrees to remove and load out the coal as directed by COAL COMPANY'S ENGINEER and in the manner described in the Specifications.

Equipment To Be Used

ARTICLE 19.—SCHEDULE OF EQUIPMENT.

CONTRACTOR agrees to have at least the following equipment on the job, with competent and sufficient foremen, [fol. 172] operators, and laborers to operate same, and at work within the time specified after each item:

NAME, TYPE AND SIZE OF EQUIPMENT;	EQUIPMENT WILL BE AT WORK ON THE JOB WITHIN NUMBER OF DAYS INDICATED SUBSEQUENT TO DATE OF THIS CONTRACT
Power Shovels, Drills, Trucks and Miscellaneous Equipment	
Sufficient power shovels, well drills, trucks, tractors, pumps and other miscellaneous equipment to properly execute the work on this project	When required.

When Work Is To Be Done

ARTICLE 20.—START OF OPERATIONS.

CONTRACTOR agrees to enter upon the performance of said work within thirty (30) days after date of this Contract and to proceed with it continuously carrying it on at such points and in such order and at such times as he may from time to time be directed by COAL COMPANY'S ENGINEER and in no case to proceed without first obtaining from COAL COMPANY'S ENGINEER complete directions for the proper execution of work.

ARTICLE 21.—RATE OF REMOVAL OF OVERBURDEN.

CONTRACTOR agrees, unless delayed by fires, strikes, floods or other unavoidable casualties, or by the written instructions of COAL COMPANY, to remove the overburden and divider slate at such a rate that the coal production requirements as set forth in Article 22 shall at all times be attainable.

ARTICLE 22.—SCHEDULE OF COAL EXTRACTION.

CONTRACTOR agrees, unless delayed by fires, strikes, floods or other unavoidable casualties, or by the written instructions of COAL COMPANY, to produce, and to maintain the stripping and mining operations in condition to produce the maximum number of gross tons of raw coal obtainable per single seven (7) hour shift, beginning at a reasonable time after the date of this contract and continuing thereafter to completion of the project.

After completing the removal of coal by dipper shovel, CONTRACTOR shall install drag shovel equipment to recover, to the satisfaction of COAL COMPANY'S ENGINEER, whatever coal that cannot be recovered by dipper shovel.

[fol. 173] ARTICLE 23.—SUSPENSION OF WORK.

(a) CONTRACTOR covenants and agrees that COAL COMPANY shall have the right to entirely cancel and terminate this contract, without specifying any reason therefore, upon thirty (30) days' notice in writing to CONTRACTOR of COAL COMPANY'S intention so to do, and in that event COAL

COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or any other damages whatsoever.

(b) CONTRACTOR further covenants and agrees that COAL COMPANY shall have the right to temporarily suspend work under this contract at any time or times by giving CONTRACTOR written notice of COAL COMPANY'S intention so to do. Should any such temporary suspension be made and continue for a period of five (5) weeks, except in case of strike or lockout, CONTRACTOR may notify COAL COMPANY in writing of CONTRACTOR'S desire to cancel this contract and, if within thirty (30) days after receipt of said notice COAL COMPANY fails to give CONTRACTOR a written order to resume work, then CONTRACTOR may thereupon, by written notice served upon COAL COMPANY, forthwith cancel and terminate this contract. In the event of any such cancellation by CONTRACTOR, COAL COMPANY shall not be liable to CONTRACTOR for any loss of anticipated profits or other damages whatsoever. If no such notice to cancel this contract has been given by CONTRACTOR and COAL COMPANY desires at any time a resumption of the work under this contract, it shall so notify CONTRACTOR, and upon receipt of such notice CONTRACTOR agrees that he will, within five (5) days thereafter, resume operation.

ARTICLE 24.—INTERRUPTION OF WORK.

It is the understanding of both parties that COAL COMPANY shall in no wise be held liable to CONTRACTOR for any interruptions or hindrance to the regular and continuous prosecution of the work to be performed by CONTRACTOR under the terms of this contract that may be caused by strikes of the workmen of COAL COMPANY, or through the interference of such workmen of COAL COMPANY with the workmen of CONTRACTOR, or that may be caused by any other occurrences beyond the control of COAL COMPANY.

Other Obligations of CONTRACTOR.

ARTICLE 25.—TAXES, OLD AGE BENEFITS, WORKMEN'S COMPENSATION, UNEMPLOYMENT INSURANCE AND PUBLIC LIABILITY INSURANCE.

CONTRACTOR agrees that he and each of his subcontractors will deduct from the wages of his, its, or their employees

and pay over to the proper authorities any tax or taxes as required by any State or Federal Laws and will comply with all State and Federal Laws relating to Old Age Benefits, Workmen's Compensation and Unemployment Insurance, including provision for the payment of Workmen's Compensation benefits to his employees or their dependents in accordance with the laws of the Commonwealth of Pennsylvania and all amendments thereto.

[fol. 174] CONTRACTOR also agrees that he and each of his subcontractors shall carry a Public Liability Policy, with limits of at least $25,000 for any one person and $50,000 for any one accident. Before any of the employees of CONTRACTOR or employees of his subcontractors shall do any work upon the premises of COAL COMPANY, CONTRACTOR agrees to furnish COAL COMPANY with a certificate that such insurance coverage has been provided; said certificate to contain the date when the coverage expires. CONTRACTOR agrees that the coverage shall not be cancelled until after all work required by this Contract is completed.

ARTICLE 26.—SURETY BOND.

If COAL COMPANY so requests, CONTRACTOR agrees to deliver to said COAL COMPANY, before the expiration of fifteen (15) days from the date of such request and, before any further payment hereunder shall become due from COAL COMPANY, a bond for the faithful performance of this Contract by CONTRACTOR in a form and in a penal sum satisfactory to COAL COMPANY executed by CONTRACTOR as principal and by a surety company satisfactory to COAL COMPANY as surety, the cost of said bond to be paid by COAL COMPANY.

ARTICLE 27.—PERMITS FROM PUBLIC AUTHORITIES.

CONTRACTOR agrees to obtain and pay for all permits from public authorities which may be required in connection with the performance of this contract, and to comply with all municipal and other public laws, ordinances, and requirements in regard to the same, and with all rules and regulations of any insurance companies which may have issued policies upon any part of the work or who may be asked

to do so. CONTRACTOR also agrees to comply with the lawful orders of any public authority made from time to time in respect to the work to be done hereunder.

ARTICLE 28.—EMPLOYEES

CONTRACTOR agrees to employ competent workmen and foremen, and immediately to discharge, whenever ordered to do so by COAL COMPANY, any person considered by COAL COMPANY incompetent, or disposed to be disorderly, and further agrees not again to employ such person upon the work.

ARTICLE 29.—WATCHMEN.

It is the understanding of the parties hereto that COAL COMPANY shall not be responsible for the loss of or damage to the property of CONTRACTOR and/or his subcontractors (if any) from any cause. CONTRACTOR shall furnish whatever watchmen he finds necessary adequately to protect his interests.

ARTICLE 30.—PRECAUTIONS TO BE TAKEN BY CONTRACTOR.

CONTRACTOR agrees to use due care throughout the work, and that whenever the Specifications for any part of the work are, in his opinion, faulty, or at variance with any [fol. 175] rules or ordinances applying to the work, or are such as will, if followed, result in unsafe conditions or will cause the work to result in pecuniary loss to COAL COMPANY or in any damage or loss to persons or property, he will instantly stop work on the portion affected thereby and immediately notify COAL COMPANY in writing of such opinion, and in what respect he considers said Specifications are faulty or at variance as aforesaid and CONTRACTOR will not proceed with the part of the work so affected until he has received a written order from COAL COMPANY'S ENGINEER directing what is to be done and when to proceed.

ARTICLE 31.—PROTECTION OF COAL COMPANY.

CONTRACTOR further covenants and agrees that he will indemnify and save harmless COAL COMPANY, its successors

and assigns, of and from any loss, damage, cost, charge or expense, whether direct or indirect and whether to persons or property, to which COAL COMPANY, or its successors or assigns, may be subjected by any act, action, neglect or default on the part of CONTRACTOR or his subcontractors or any of CONTRACTOR's or sub-contractors' officers, agents or employees.

If at any time during the progress of the work, CONTRACTOR shall allow any indebtedness to become due for labor, materials or services, whether said indebtedness may or may not become a lien or liens upon property of COAL COMPANY, or whether said indebtedness may or may not become a claim against COAL COMPANY, and shall permit said indebtedness to remain unpaid for a period of fifteen (15) days, CONTRACTOR shall immediately upon request from COAL COMPANY, pay the same, or cause the same to be secured by giving a bond, or otherwise, and in case of his failure so to do, COAL COMPANY, at its option, may withhold any money due CONTRACTOR until such indebtedness is paid or may apply such money towards the discharge thereof, or may forthwith terminate the employment of CONTRACTOR and proceed in accordance with the provisions of Article 47 hereof.

ARTICLE 32.—LIABILITY FOR DAMAGE TO OTHER CONTRACTORS.

If CONTRACTOR should cause damage to any other contractor on the stripping and mining operations, he agrees upon due notice to settle with such other contractor by agreement or arbitration. If any other contractor claiming damages sues COAL COMPANY on account of any damage alleged to have been sustained, COAL COMPANY shall notify CONTRACTOR who agrees to defend such proceedings at his own expense. If any judgment against COAL COMPANY arises therefrom, CONTRACTOR agrees to pay or satisfy it and pay all costs incurred by COAL COMPANY.

ARTICLE 33.—SUBCONTRACTING AND ASSIGNING.

CONTRACTOR further covenants and agrees that he will not sell, assign, transfer or set over this contract or any part or interest therein to any person or persons whomso-

ever, without the consent in writing of COAL COMPANY, and any such sale, assignment or transfer, without such written [fol. 175a] consent from COAL COMPANY, shall be null and void. Any subcontracts entered into by CONTRACTOR shall be submitted to COAL COMPANY for approval and COAL COMPANY shall have the right to reject any subcontractor whom COAL COMPANY considers incompetent or unable satisfactorily to perform the portion of the work involved, and in that case such subcontractor shall do no work hereunder.

CONTRACTOR agrees to impose on the subcontractors under his charge the same responsibilities which CONTRACTOR assumes by these terms and conditions and the contract in general, and CONTRACTOR agrees that he will be fully responsible to COAL COMPANY for the acts and omissions of his subcontractors and of persons either directly or indirectly employed by all subcontractors.

ARTICLE 34.—LIENS.

No claim or mechanic's lien shall be filed by anyone against the tracts of ground upon which the stripping and mining operations are to be conducted or the buildings, machinery, or other "structure" (as defined by the Pennsylvania Mechanics Lien Act), erected thereon or any part thereof, whether so conducted, erected and constructed strictly in accordance with the provisions of the Contract Documents, or in accordance with any amendments thereof. CONTRACTOR shall execute in a form supplied by and acceptable to COAL COMPANY a separate agreement with COAL COMPANY to this effect so that the same may be duly filed.

ARTICLE 35.—COAL COMPANY'S OCCUPANCY OF PREMISES.

CONTRACTOR agrees that COAL COMPANY may, during the progress of the work, place and install or cause to be placed and installed within the area covered by these stripping and mining operations such other structures, equipment and materials and may carry on such other operations as it may deem desirable for its own purposes, before the completion of the various parts of the work, provided,

however, that such use of portions of said area shall not substantially interfere with the work of CONTRACTOR, and CONTRACTOR further agrees that such placing and installation of structures, equipment and material shall not in any way evidence the completion of the work or any portion of it, nor shall be deemed or construed to signify COAL COMPANY'S acceptance of the work or any part thereof.

ARTICLE 36.—REMOVAL OF CONTRACTOR'S EQUIPMENT.

Upon the completion of the work to the satisfaction of COAL COMPANY, CONTRACTOR agrees to remove from the premises at his own expense all equipment, machinery and structures used by him in the said stripping and mining operations.

[fol. 176] PART FOUR.—OBLIGATIONS OF COAL COMPANY

Prices To Be Paid for the Work.

ARTICLE 37.—CONTRACT PRICE.

COAL COMPANY hereby agrees to pay to CONTRACTOR as full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work described by the Contract Documents and by any detailed drawings and specifications which may be hereafter prepared or which work and materials are, in case of dispute, found to be so required; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith, the price of one dollar and eighty-five cents ($1.85) per gross ton as determined by scale weight in trucks of CONTRACTOR at COAL COMPANY'S Westwood Colliery for each and every ton of raw coal delivered into the raw coal chute at Westwood Breaker, under the conditions provided in the Contract Documents.

ARTICLE 38.—STRIPPING WORK WAGE SCALE.

It is hereby agreed that the contract price under this contract is based on the wage scale as provided in the wage agreements between the United Mine Workers of America and the Anthracite Operators of November 17, 1917 and subsequent agreements of November 15, 1918, September 2, 1920, September 19, 1923, February 17, 1926, August 8, 1930, May 7, 1936, May 26, 1939, May 20, 1941, January 9, 1943 and March 8, 1944; and/or special or local wage agreements between the United Mine Workers of America and the Stripping Contractors in District 9, covering shovel operators, dated June 11, 1940 and July 15, 1944, for this class of work in the Anthracite region.

In the event of an increase or decrease in the labor costs of CONTRACTOR by reason of an increase or decrease of the labor wage scale, and/or a resumption of a five day work week instead of a six day work week, the contract price to be paid to CONTRACTOR hereunder shall be increased or decreased in an amount equal to such increased or decreased labor cost to CONTRACTOR.

CONTRACTOR hereby agrees to keep at all times adequate books of account and cost records, including records of all wages paid to labor, to immediately post said books upon request of COAL COMPANY so to do, and to permit COAL COMPANY at all reasonable times to examine and take extracts from said records for the purpose of determining the amount of any increase or decrease in CONTRACTOR's labor costs by reason of any such change in the labor wage scale.

In case the books of account and cost records kept by CONTRACTOR are insufficient or in improper form to permit COAL COMPANY to ascertain the amount of any increase or decrease in CONTRACTOR's labor costs by reason of change in the labor wage scale, than and in that event COAL COMPANY shall specify what increase or decrease shall be made [fol. 177] in the contract prices as compensation for any such increase or decrease in the labor wage scale and CONTRACTOR shall accept same.

Terms of Payment

ARTICLE 39.—TIME AND METHOD OF PAYMENT.

The time and method of payment will be as follows:

CONTRACTOR will be paid on the regular stripping semi-monthly pay day schedule for each and every ton of raw coal that passes over the raw coal scale at COAL COMPANY's Westwood Colliery during the period covered by the pay day schedule.

No additional retainer will be required on this contract, but it is the understanding of both parties that the amount of $2500 which is held by the COAL COMPANY as retainer until the completion of the P-22 Stripping Contract, will be carried over to this contract, which sum will be held by COAL COMPANY until completion of this contract as a guarantee for the faithful performance by CONTRACTOR of this contract.

Other Obligations of COAL COMPANY

ARTICLE 40.—

Blank.

ARTICLE 41.—

Blank.

ARTICLE 42.—

Blank.

ARTICLE 43.—

Blank.

ARTICLE 44.—PROVIDE DRAWINGS.

COAL COMPANY agrees to furnish to CONTRACTOR, free of charge, all copies of Drawings and Specifications reasonably necessary for the execution of the work.

It is the understanding of both parties that all drawings, specifications and copies thereof furnished by COAL COMPANY shall remain the property of COAL COMPANY. No part or all of these shall be used by CONTRACTOR on other work

and, with the exception of the specifications attached to CONTRACTOR's original copy of this Contract, they shall be returned to COAL COMPANY upon request upon termination of his work under this Contract.

[fol. 178] ARTICLE 45.—SURVEYS, LINES AND GRADES.

COAL COMPANY'S ENGINEER will furnish surveys establishing with sufficient definiteness grade lines for the construction of all transportation and/or other facilities by CONTRACTOR.

ARTICLE 46.—TEMPORARY BUILDINGS.

COAL COMPANY agrees to permit CONTRACTOR to erect at his own expense at such points and places as COAL COMPANY'S ENGINEER shall designate for the purpose, such buildings as may be necessary to carry on the work under this agreement, which buildings are to be removed by CONTRACTOR upon termination of his work done under this Contract. If CONTRACTOR fails to so remove said buildings, COAL COMPANY may do so at CONTRACTOR'S expense and CONTRACTOR agrees to immediately pay the same upon receipt of a bill therefore from COAL COMPANY, or COAL COMPANY may deduct such amount from sums then due and owing the CONTRACTOR by COAL COMPANY.

PART FIVE.—GENERAL PROVISIONS.

ARTICLE 47.—FORFEITURE OF CONTRACT.

In the event that CONTRACTOR should at any time refuse or neglect to supply a sufficient number of properly skilled workmen, plant, equipment or materials of the proper quantity or quality or fail in any respect to prosecute the work with sufficient promptness and diligence, or fail in the performance of any of the covenants and agreements herein contained, such refusal, neglect or failure being certified by COAL COMPANY'S ENGINEER, COAL COMPANY shall be at liberty, after three days' written notice to CONTRACTOR, to provide any such labor, plant, equipment or materials, and to deduct the cost thereof from any money then due or thereafter to become due to CONTRACTOR under this con-

tract; and if said COAL COMPANY'S ENGINEER shall certify that such refusal, neglect or failure is sufficient ground for such action, COAL COMPANY shall also be at liberty to terminate the employment of CONTRACTOR for the said work and to enter upon the premises and take possession, for the purpose of completing the work included under this contract, of all plant, equipment, materials, tools, and appliances thereon, and to employ any other person or persons to finish the work, and to provide the materials therefore; and in case of such discontinuance of the employment of CONTRACTOR he shall not be entitled to receive any further payment under this contract until the said work shall be wholly finished, at which time, if the unpaid balance of the amount to be paid under this contract shall exceed the expense incurred by COAL COMPANY in finishing the work, such excess shall be paid by COAL COMPANY to CONTRACTOR. But if such expense shall exceed such unpaid balance, CONTRACTOR shall pay the difference to COAL COMPANY. The expense incurred by COAL COMPANY as herein provided, either for furnishing materials or for finishing the work, and any damage incurred through such default, shall be audited and certified by the Treasurer of COAL COMPANY whose certificate thereof shall be conclusive upon the parties unless objected to in writing within ten days from certification and service. In case an objection to the certificate [fol. 179] of the Treasurer shall be filed within the time specified as aforesaid, the accuracy of the said certificate shall be determined by arbitration.

ARTICLE 48.—ARBITRATION.

Whenever under any of the provisions of this Contract it is provided that any question shall be determined by arbitration at the instance of either COAL COMPANY or CONTRACTOR, the question at the time in dispute shall be determined by three arbitrators selected or appointed as hereinafter provided. The party desiring arbitration shall give written notice to the other party setting forth in general terms the question or questions to be arbitrated and determined and the section or sections of this Contract under which the right of arbitration arises, and in said

notice shall appoint an arbitrator. Within ten days thereafter the party so notified shall appoint in writing an arbitrator and shall give written notice of such appointment to the party desiring arbitration; but if within said ten days the said arbitrator is not so appointed and notified to the party desiring arbitration, then the party desiring arbitration may make application to the then President of The Fidelity-Philadelphia Trust Company of Philadelphia for the appointment of such arbitrator; and it is hereby agreed that the said President may appoint such arbitrator. The first arbitrator and the second arbitrator so appointed shall, within ten days after the appointment of the latter, select a third arbitrator, but if they shall fail so to do within said period of ten days, either party may make application to the then President of the Fidelity-Philadelphia Trust Company of Philadelphia for the appointment of a third arbitrator, and it is hereby agreed that the said President may appoint such arbitrator. The decision of a majority of the three arbitrators so appointed and selected shall be final, binding and conclusive upon both parties hereto without any right of appeal therefrom to any Court, except such as is provided for in the Act of Assembly of the Commonwealth of Pennsylvania approved April 25, 1927, P. L. 381. Each party shall bear its own cost and expense of arbitration. The costs and expenses incurred by the arbitrators, including their reasonable compensation, shall be paid in equal shares by COAL COMPANY and CONTRACTOR.

The provisions of the said Act of Assembly of the Commonwealth of Pennsylvania, as the same may be amended and supplemented from time to time, shall be applicable to the arbitration herein provided for.

ARTICLE 49.—PREVIOUS COMMUNICATIONS.

All previous communications between the parties hereto, either verbal or written, are hereby abrogated and withdrawn, and this contract with the Specifications referred to herein constitutes the whole agreement between the parties hereto.

[fol. 180] IN WITNESS WHEREOF, the parties to this agreement have hereunto set their hands and seals as of the day and year first above written.

Signed, sealed and delivered
in the presence of us:

/s/ JOSEPH CHAMBERLAIN /s/ GEORGE W. HUSS (SEAL)
George W. Huss

/s/ JOSEPH CHAMBERLAIN /s/ RUSSELL N. HUSS (SEAL)
Russell N. Huss

/s/ JOSEPH CHAMBERLAIN /s/ WESLEY W. HUSS (SEAL)
Wesley W. Huss

Partners, Trading and Doing Business
as GEORGE W. HUSS CONTRACTING COMPANY,
a Partnership.

CONTRACTOR.

THE PHILADELPHIA AND READING COAL
AND IRON COMPANY (SEAL)

By /s/ R. E. TAGGART
President

Attest: /s/ M. P. MCDERMOTT
Secretary

COAL COMPANY.

[fol. 182]

SPECIFICATIONS

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[fol. 183]

Specifications

for

Stripping and Mining the Various Veins on the North and South Dips at Tower City Section, in Areas Designated by the Coal Company's Engineer—Stripping No. P-22B

The Philadelphia and Reading Coal and Iron Company, Pottsville, Pennsylvania.

I.—GENERAL.

This Specification and Drawings listed hereinunder are a part of the "Contract Documents" which shall apply in full and in part.

II.—DRAWINGS.

The drawings above referred to are the mine maps of the Coal Company that are available for reference in the Coal Company's office.

III.—DESCRIPTION OF PROJECT.

The work covered by this specification includes the performance of all work and the furnishing and paying for all the material, labor, tools, equipment, water, light, power, transportation and other facilities, unless specified otherwise, hereinafter, required for the excavation, removal and disposal of all overburden materials and divider slate lying over, between and/or in the veins of coal and for mining, transporting to and delivery into the raw coal chute at Westwood Breaker of all the raw coal that is recoverable by stripping in the area designated by COAL COMPANY'S ENGINEER and within the limits set forth by said COAL COMPANY'S ENGINEER, all the above to be done in accordance with the Contract Documents referred to herein.

IV.—LOCATION AND LIMITS OF PROJECT.

It is the understanding of the parties hereto that the project referred to above is the stripping areas in the various veins on the North and South Dips at the Tower City Section, as designated by the COAL COMPANY'S ENGINEER and located on the Swatara Coal Company Lands and Munson and Williams Lands, Porter Township, Schuylkill County, Pennsylvania, which lands are owned by COAL COMPANY.

It is further understood by the parties hereto that the minimum acceptable stripping ratio shall be an average for the entire project of four (4.0) place cubic yards of overburden per gross ton of raw coal recovered.

[fol. 184] V.—PROCEDURE.

CONTRACTOR shall conduct stripping and mining operations on the project in a manner which will permit producing coal at the rate and under the conditions described in Article 22 of the Contract.

VI.—OVERBURDEN DISPOSAL.

CONTRACTOR will comply with instructions from COAL COMPANY'S ENGINEER regarding the disposal of overburden

and divider slate. It is distinctly understood and agreed that nothing herein contained shall be considered as implying or controlling the destination or place of dumping of the material carried away under the terms of this contract. The destination of the material carried away is exclusively within the control of the CONTRACTOR.

VII.—REMOVAL OF SURFACE REFUSE.

All surface stone, dirt and clay washed into the stripping pits must be kept out of the coal loaded by CONTRACTOR at his own expense.

VIII.—REFUSE IN RAW COAL.

CONTRACTOR shall so conduct stripping and mining operations as to keep at a minimum "extraneous refuse" loaded with the coal, and he agrees to be controlled in this matter by the instructions of COAL COMPANY'S ENGINEER, and to be bound by his decision.

IX.—POINT OF DELIVERY OF COAL.

CONTRACTOR will deliver and dump the raw coal into the raw coal chute at Westwood Breaker owned by COAL COMPANY and located at Westwood Colliery.

X.—RAW COAL CHUTE AT WESTWOOD BREAKER.

COAL COMPANY agrees to permit CONTRACTOR to enter upon COAL COMPANY'S premises for delivery of raw coal to the raw coal chute at Westwood Breaker.

XI.—OTHER PROVISIONS.

(a) Power

CONTRACTOR shall, at his own expense, provide all power required for operation of the project.

(b) Water

CONTRACTOR shall, at his own expense, provide all water required for operation of the project.

(c) Roads and Track

CONTRACTOR shall, at his own expense, provide all roads, [fol. 185] and/or tracks required for the handling, removal and disposal of overburden and coal, and for delivery of raw coal to the raw coal chute at Westwood Breaker.

(d) Outlet Cuts

CONTRACTOR shall, at his own expense, provide all outlet cuts required for the handling, removal and disposal of overburden and coal, and for delivery of raw coal mined to the raw coal chute at Westwood Breaker.

(e) Railroad Siding

The Reading Railroad spur tracks at Good Spring are at present available to the CONTRACTOR for bringing to the project all equipment and materials required for the completion of the work on the project.

CONTRACTOR shall provide all facilities and labor to unload and store all his own material, apparatus and equipment, and shall be entirely responsible for same.

Less-than-carload shipments shall be handled through the nearest local railroad freight house, and CONTRACTOR shall arrange for the delivery of such shipments to the location of his job.

JUL 25 1958
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1958.

No. 218

EMORY W. PARSONS and ERMA M. PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

No.

HOWARD H. PARSONS and MARTHA PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

No.

LAWRENCE H. PARSONS and GRACE E. PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

SHERWIN T. McDOWELL,
1035 Land Title Building,
Philadelphia, Pa.,

CHARLES I. THOMPSON, JR.,
Attorneys for Petitioners.

BALLARD, SPAHR, ANDREWS & INGERSOLL,
Of Counsel.

International, 711 So. 50th St., Phila. 43, Pa.

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IN THE

Supreme Court of the United States.

October Term, 1958

No.

EMORY W. PARSONS AND ERMA M. PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,
Respondent.

No.

HOWARD H. PARSONS AND MARTHA PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,
Respondent.

No.

LAWRENCE H. PARSONS AND GRACE E. PARSONS,
Petitioners,

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Emory W. Parsons, Erma M. Parsons, Howard H. Parsons, Martha Parsons, Lawrence H. Parsons, and Grace E. Parsons pray that writs of certiorari issue to review the judgments of the United States Court of Appeals for the Third Circuit entered in three cases, *viz., Emory W. Parsons and Erma M. Parsons v. Smith, Howard H. Parsons and Martha Parsons v. Smith,* and *Lawrence H. Parsons and Grace E. Parsons v. Smith,* on March 27, 1958. Since they involve identical questions, this petition covers all three cases.

OPINIONS BELOW.

The three cases with respect to which writs of certiorari are here sought were consolidated for trial before the United States District Court for the Eastern District of Pennsylvania and, upon appeal, were consolidated for hearing before the Court of Appeals. The opinion of the District Court (8a),[1] which was not reported officially, is unofficially reported in 1957 P-H Fed. Tax Serv. ¶ 72,761. The opinion of the Court of Appeals affirming the District Court is printed in Appendix B, *infra* page 21, and is reported unofficially in 1 AFTR 2d 58-1266. The opinion of the Court of Appeals denying petitioners' petition for rehearing is printed in Appendix D, *infra* page 30, and is reported unofficially in 1 AFTR 2d 58-1829. Judge Kalodner dissented from the Court of Appeals' denial of the petition for rehearing, stating that his views are expressed at length in his dissenting opinion rendered in connection

1. This and similar references are to page numbers of the petitioners' Appendix filed with the Court of Appeals.

with the Court of Appeals' denial of a petition for rehearing in *Huss, et al. v. Smith.* Judge Kalodner's dissenting opinion in *Huss,* which was decided against the taxpayers in that case on the same day as the present case, is set forth in full in Appendix. F, *infra* page 32.[2] Counsel for petitioners are advised that the taxpayers in *Huss* also propose to file a petition for writ of certiorari with this Court.

JURISDICTION.

The judgments of the Court of Appeals, printed in Appendix C, *infra* page 28, were entered on March 27, 1958. A petition for rehearing, timely filed before April 25, 1958 pursuant to order of the Court dated April 10, 1958, was denied May 29, 1958. The order denying the petition for rehearing is printed in Appendix E, *infra* p. 31.

Petitioners invoke the jurisdiction of this Court under Section 1254(1) of the Judicial Code, 28 U. S. C. § 1254(1).

QUESTION PRESENTED.

Whether the Court of Appeals for the Third Circuit erred in holding that a partnership in the business of strip mining coal had no depletable economic interest in the coal because its agreement with the owner was terminable by either party upon ten days' notice, and because it was paid a stated price per ton for coal delivered to the owner; notwithstanding the fact (which the dissent below considered controlling) that it had the exclusive right to mine to exhaustion all coal uncovered by it, bore the entire risk of the enterprise, and was paid only for merchantable coal discovered and delivered.

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2. The opinion of the Court of Appeals in the *Huss* case is reported unofficially in 1 AFTR 2d 58-1264, and the Court's opinion upon its denial of petition for rehearing is reported unofficially in 1 AFTR 2d 58-1834.

STATUTES AND REGULATIONS INVOLVED.

The statutory provisions involved are Sections 23(m), 23(n), and 114(b)(4) of the Internal Revenue Code of 1939, 26 U.S.C. § § 23(m), (n), 114(b)(4). They are printed in Appendix A, *infra* page 19.[3] The regulations involved are Treasury Regulations 111, 26 *Code Fed. Regs.* § 29.23 (m)-1 (1949). They are printed in Appendix A, *infra* page 20.

STATEMENT OF THE CASE.

A. The Nature of the Proceeding.

These cases involve suits for refund of income taxes paid with respect to the calendar years 1945 through 1949, and aggregating approximately $63,000.

During the taxable years in question Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons were partners in an enterprise engaged in the business of strip mining coal in the bituminous regions of Pennsylvania. In the partnership returns filed for the taxable years, no depletion allowance was claimed in respect of the partnership's gross income from the mining, thereby increasing each partner's share of the partnership net distributable income required to be reported in his individual joint income tax return. The partners (joined by their respective wives) individually filed refund claims for the resultant overpayment of income tax, and upon disallowance thereof, pursuant to Section 1340 of the Judicial Code, 28 U. S. C. § 1340, commenced suit in the District Court to recover

3. The provisions of the Internal Revenue Code cited are those applicable to the taxable years here involved. There has been no substantial change in those provisions affecting the question presented by this case. Compare Sections 611(a) and 613 of the Internal Revenue Code of 1954, 26 U. S. C. §§ 611(a), 613.

the tax from the Collector of Internal Revenue to whom it had been paid. The District Court entered judgment for the defendant, and the Court of Appeals affirmed.

The sole issue is whether the Court of Appeals was correct in holding that the partnership was entitled to no deduction for percentage depletion with respect to amounts received by it from the owner of the coal lands in payment for coal delivered during the taxable years in question. Decision of this issue turns upon the basic question whether the partnership had an economic interest in the coal in place during such years. *Kirby Petroleum Company v. Commissioner*, 326 U. S. 599 (1946).

B. Facts.

The facts of this case, as found by the District Court, are as follows:

During the taxable years in question, Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons were members of a partnership ("Parsons") engaged in removing overburden and strip mining coal on the property of Rockhill Coal Company ("Rockhill") under an oral agreement entered into in 1942. The areas to be stripped were selected by Rockhill's engineering department after consultation with Parsons, and, generally, prospecting was 60% successful (8a, 12a, 14a, 18a, 19a).

The oral agreement could be terminated by either party on ten days' notice. However, if Rockhill cancelled on ten days' notice and Parsons had previously gone to the expense of removing the overburden (thereby performing the heavy part of the work, as well as meeting wages and expenses in so doing), then Parsons would have the privilege of taking out the coal under the above mentioned, removed overburden and of being paid for it, even though this took more than ten days. Parsons was not bound to remain until the prospected coal was exhausted. It had the right, however, to stay and take out from the coal it found

as much coal as it economically could take out at a profit with its equipment (14a, 15a).

The amount of equipment, the number of its employees, and the quantity of coal stripped (subject to Rockhill's right of termination) were in the discretion of Parsons. The equipment used by Parsons either belonged to it or was leased from Rockhill, and Parsons bore the entire expense of the operation. Parsons was paid a stated amount per ton of coal delivered to Rockhill's railroad cars, subject to increase to reflect its costs (15a, 16a, 21a-22a).

On August 1, 1950 Parsons gave Rockhill notice that it intended to cease its operations. Thereafter it continued to strip mine coal that had been cleared of overburden until September 5, 1950, when no coal was left uncovered (24a).

C. Decisions of the Courts Below.

On the basis of the foregoing facts, the District Court held that Parsons had no economic interest in the coal mined by it during the taxable years and, consequently, was entitled to no allowance for percentage depletion. The Court based its decision upon three grounds:

(1) Parsons' contract was terminable by Rockhill upon ten days' notice (26a);

(2) Parsons was paid a stated price per ton, irrespective of the market price (26a); and

(3) The coal remained an asset of Rockhill (28a).

In affirming the judgment of the District Court, the Court of Appeals adopted the first two of the foregoing grounds relied upon by the District Court, and ignored the third. The latter action was eminently proper, for it is well settled that the term "economic interest" does not mean title to, or ownership of, the mineral. *Palmer v. Bender*, 287 U. S. 551, 557 (1933). However, the Court of

Appeals commented upon a third factor which, it said, "deserves separate mention", *viz.*, that Parsons had no capital investment in the coal beyond the contribution of depreciable equipment suitable for other uses.

Judge Kalodner dissented from the Court of Appeals' denial of petition for rehearing, incorporating by reference his views expressed in *Huss*, and stating (*infra*, p. 30):

> "The taxpayers here, as in the Huss cases, were granted an exclusive right to remove all the merchantable coal in place in the reserved or leased area. They had a right of control over production of the mineral in place which gives rise to the economic interest necessary for the depletion allowance. Burton-Sutton Oil Company v. Commissioner, 328 U. S. 25, 29, 32 (1946). All the coal involved was produced during the existence of this interest. The fact that such interest might have been brought to an end someday in the future is not a relevant consideration."

D. Petitioners' Position.

No case involving the right of coal strippers to depletion allowances has yet been decided by this Court. However, in many oil and gas cases this Court has often stated that the taxpayer owns the requisite economic interest if his income is dependent solely upon production of the mineral. Most recently, in *Commissioner v. Southwest Exploration Company*, 350 U. S. 308 (1956), the Court determined that coastal land owners who permitted operators the use of their land in reaching off-shore oil deposits had an economic interest in the deposits. As required by state law, the operators obtained from the coastal land owners the right to erect drilling equipment on their land and, by a process known as whipstocking, reached the oil deposit in the ocean. Neither the land owners nor the operators supposed that the former had any oil on their land, and, indeed, the operations were designed to, and did, reach oil which

was not on their lands. This Court held that the land owners had an economic interest in the oil:

> "Their contribution [of land] was an investment in the oil in place sufficient to establish their economic interest. Their income was dependent entirely on production, and the value of their interest decreased with each barrel of oil produced. No more is required by any of the earlier cases."

The lower courts have applied the same basic test to coal strippers. In *Commissioner v. Gregory Run Coal Company*, 212 F. 2d 52 (4th Cir. 1954),[4] the Court of Appeals stated, in holding that the coal strippers in that case were entitled to depletion deductions:

> "We think, however, that in the pending case the rights of the producers were completely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

It is petitioners' position that Parsons falls four square within the principles enunciated by this Court. Parsons bore the entire cost of the stripping operation, with no expectation of income unless and until it succeeded in discovering and delivering coal to Rockhill. Since Parsons' income was dependent solely upon the production of coal, it is accordingly entitled to the depletion allowances.

It is further petitioners' position that denial of the depletion deductions to Parsons would defeat the fundamental purpose of the depletion allowance and the Congressional intent in enacting the depletion provisions of the revenue laws. Congress intended the depletion allowance

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4. Cert. den., 348 U. S. 828 (1954).

to compensate those who bear the risk of discovering minerals.[5] Under its contract Parsons was burdened with all the risk, and received no income whatever until it was successful in finding and producing marketable coal. Manifestly, therefore, to it must belong the compensation provided by Congress for entrepeneurs who prospect for and produce minerals at the risk of losing their entire investment if they are unsuccessful.

REASONS FOR GRANTING THE WRITS.

I. The Decision of the Court of Appeals Below Is Squarely in Conflict With the Decisions of the Court of Appeals for the Fourth Circuit.

As stated heretofore, the Court of Appeals relied principally upon two grounds: (1) that Parsons' contract was terminable upon ten days' notice (*infra*, p. 24), and (2) that Parsons was paid a stated price per ton for coal mined and delivered to Rockhill (*infra*, p. 24). On both counts the Court of Appeals is in direct conflict with the decisions of the Court of Appeals for the Fourth Circuit holding that neither factor deprives the coal stripper of his economic interest.

A. *The Termination Clause.* In discussing the Fourth Circuit's decisions with respect to terminability, the Court of Appeals sought to evade their impact by terming them "borderline cases" (*infra*, p. 25). It is difficult to conceive, however, of a decision more squarely in point and more contrary to the present decision than the Fourth Circuit's holding in *Weirton Ice and Coal Supply Company v. Commissioner*, 231 F. 2d 531, 535-36 (4th Cir. 1956), wherein the Court stated:

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5. Sen. Rep. No. 617, 65th Cong., 3rd Sess., 1939-1 (Part 2) Cum. Bull. 122; H. R. Rep. No. 1, 69th Cong., 1st Sess., 1939-1 (Part 2) Cum. Bull. 319.

> "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 in the enterprise. *It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all of the taxable years.* We think that Weirton's rights were dependent solely upon the extraction and delivery of the coal, and that the relationship of the parties to the ore in place gave it an economic interest in the mineral and entitled it to share with National the depletion allowance provided by the statute." (Emphasis added)

See also *Hamill Coal Corp. v. Commissioner*, 239 F. 2d 347 (4th Cir. 1956) (stripper had economic interest where contract terminable upon ninety days' notice); *Commissioner v. Gregory Run Coal Company, supra* (stripper had economic interest where contract terminable upon thirty days' notice).

The disagreement between the Circuits with respect to terminability centers upon their divergent views as to the significance of the fact that the coal strippers involved actually mined all the coal in respect of which depletion allowances are sought. Under Parsons' contract it had an indefeasible right to remove all coal uncovered in the course of its operation, even though this required more than ten days. Notwithstanding this fact and the fact that Parsons seeks depletion allowances only as to coal actually mined and delivered, the Court of Appeals below thought that Rockhill's unexercised right to prevent further mining at some indefinite future time was of crucial importance in determining whether Parsons possessed the requisite economic interest. The Court of Appeals for the Fourth Circuit takes a more realistic view which accords with the

decisions of this Court. It holds that if the stripper's income is dependent entirely upon production, it owns the requisite economic interest in all the coal which it in fact mines. Of necessity, therefore, the owner's right to terminate the contract as to coal yet undiscovered and unmined has no relevance.

In his dissenting opinion in *Huss*, Judge Kalodner succinctly underlined the disparity between the Circuits in recording his agreement with the holdings of the Fourth Circuit (*infra*, pp. 33-4).[6]

> "Nothing was said by the Supreme Court in [the Southwest] case on the score as to the impact of a right of termination of a contract creating an economic interest on the existence of that interest in the first place. Nor has the Supreme Court said so in any other case. We did not consider nor did we pass upon this question in Commissioner v. Mammoth Coal, 229 F. 2d 255 (1955). Nor has any other appellate court done so, except the Fourth Circuit. That Circuit, however, has explicitly ruled that a right of termination does not destroy an economic interest which existed prior to its exercise. It did so in two cases: Weirton Ice and Coal Supply Co. v. Commissioner, 231 F. 2d 531, 533 (1956) and Commissioner v. Hamill Coal Corp., 239 F. 2d 347 (1956).
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> • • •
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> "I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commis-

6. The language of the Court of Appeals for the Ninth Circuit in *Usibelli v. Commissioner*, 229 F. 2d 539 (9th Cir. 1955), indicates that Court may be in accord with the view of the Third Circuit with respect to the importance of terminability of the contract. As the Fourth Circuit pointed out in *Weirton*, however (231 F. 2d at 536), *Usibelli* involved a wholly different factual situation in that the stripper was not dependent upon discovery of coal for its income, but was paid a fixed price each year.

sioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right."

B. *The Method of Payment.* The second major ground relied upon by the Court of Appeals was that Parsons was paid a stated price per ton of coal mined and delivered to Rockhill. Since these payments did not fluctuate with the market price, the Court concluded that Parsons had no economic interest in the coal (*infra*, p. 24). This view is squarely in conflict with the decisions of the Fourth Circuit on this point.

In *Weirton* the stripper received a stated price per ton subject, as here, to adjustment to reflect increases or decreases in his labor costs. The Fourth Circuit held the stripper entitled to depletion allowances, relying upon its earlier decision in *Gregory Run*, which had expressly held that such a method of payment does not defeat an economic interest.

We believe that the view of the Court of Appeals for the Third Circuit is demonstrably erroneous. It is clear that Congress intended to compensate those who bear the risk of discovery of the mineral. Once the coal is above the ground the risks are those of sale, a problem inherent in all businesses, and therefore not warranting a special reward. Since the depletion allowance was not intended to reward businesses for assuming the risks of the market, it is obvious that the coal stripper need not assume the risk of the market in order to receive a depletion deduction.

The decision of the Court of Appeals below not only collided with the holdings of the Fourth Circuit, but also emasculated its own previous decision in *Commissioner v. Mammoth Coal Company*, 229 F. 2d 535 (3d Cir. 1955).[7] Earlier the Court had stated:

7. Rehearing denied, 229 F. 2d 539 (1956), cert. den., 352 U. S. 824 (1956).

> "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the [owner] should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

The Court's tacit reversal of *Mammoth* is all the more difficult to understand in view of the fact that both parties conceded on brief that the method of payment is irrelevant.

The conflict caused by the Court of Appeals' surprising resurrection of this issue was recognized by Judge Kalodner in his dissent in *Huss*:

> "There is also no room for doubt that the taxpayers depend solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including, but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operation profitable.
>
> "Until now, every appellate decision in this type of case, including our own decision in Commissioner v. Mammoth Coal Co., supra, has held that there is no requirement that the stripper must assume the risks of the ultimate market. To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, Commissioner v. Southwest Exploration Co., 350 U. S. at page 314, that the taxpayer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do."

The decision of the Court of Appeals in the present case places it in irreconcilable conflict with the holdings of

the Fourth Circuit.[8] Accordingly we respectfully urge the Court to issue the writs of certiorari here sought, and reconcile the conflict by reversing the judgment of the Third Circuit.

II. The Decision of the Court of Appeals Is in Direct Conflict With the Decisions of This Court.

In view of what has been said heretofore, it requires little further discussion to demonstrate that the decision of the Court of Appeals in the present case is a radical departure from the principles enunciated by this Court in its many decisions dealing with depletion of oil and gas interests. In *Southwest*, the most recent of these decisions, the Court restated in a few words the two basic essentials of an economic interest as they were originally set forth some tweny-five years ago in the landmark case of *Palmer v. Bender, supra:*

> ". . . a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital.' "

It is clear that Parsons acquired, by investment, an interest in the mineral. As this Court has often pointed out, no legal title to, or ownership of, the mineral need be acquired by such investment. As was stated in *Southwest*,

8. After the present case was submitted to the Court of Appeals below, the Fourth Circuit decided *Stilwell v. United States*, 250 F. 2d 736 (4th Cir. 1957). That case, which was brought to the attention of the Court by the petitioners and the Department of Justice, held that the stripper had an economic interest under circumstances where the contract was not terminable and the price varied with the market. This holding, of course, is not in the least inconsistent with the Court's previous decision in *Weirton*, where it was held that the stripper's economic interest is not defeated by the fact that his contract is terminable or that his price does not vary with the market.

"The allowance continues so long as minerals are extracted, and even though no money was actually invested in the deposit."[9] It is the dedication of assets to the enterprise, in precisely the manner found here, which Congress sought to encourage. Thus Parsons' investment was its commitment of its know-how, payroll, and equipment on the gamble that marketable coal could be discovered and exploited.

Second, it is plain beyond argument that Parsons could look only to the income from extraction of the coal for its return. Since it was paid only upon the delivery of marketable coal to Rockhill, it is obvious that its income was dependent solely upon the discovery and production of coal. This factor is the heart of the issue and has been emphasized by every previous decision, almost to the exclusion of other possible factors. It was, however, virtually ignored by the Court of Appeals below.

The Court of Appeals thought that Parsons' investment was insufficient because its equipment was suitable for another use, and because it could recoup its investment through deductions for depreciation. There is a short answer to this. If this view were correct, it would inescapably follow that *no* stripper (nor, indeed, any operator drilling an oil well on leased land) would be entitled to depletion. Almost all stripping equipment can be used in other businesses, and it is all depreciable. Logic dictates that the Court of Appeals repudiate all the decided cases (its own included) allowing depletion to coal strippers.

It is apparent that the decision of the Court of Appeals is in conflict with the applicable decisions of this Court, and for this reason we respectfully urge the Court to issue the writs of certiorari here sought.

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9. 350 U. S. 308, 312.

III. Determination of the Relative Rights of the Owner and Strip Miner to Percentage Depletion Is a Question of Importance in the Adminstration of the Federal Income Tax Laws Which Has Not Been, But Should Be, Settled By This Court.

While this Court has had occasion to consider the application of the depletion provisions of the Internal Revenue Code in many cases involving oil and gas properties, to date it has not considered the relative rights of parties involved in the production of coal. The strip miner has in recent years become a significant adjunct of the coal mining industry, and the respective rights of the owner of the coal lands and the stripper to claim allowance for percentage depletion for Federal income tax purposes have accordingly given rise to a vast amount of litigation. Since the question concerns the legal conclusion to be drawn from the particular facts of each case, there has developed, as might be expected, much confusion in the lower courts with respect to the importance and significance of various factors. The present case is an example. Here the Court of Appeals for the Third Circuit leaned heavily upon two factors which the Fourth Circuit considers irrelevant.

The confusion has been compounded by the fact that the depletion allowance may be apportioned between the owner and the stripper. Thus, if it is found that the stripper has an economic interest in the coal, the owner, in computing his "gross income from mining" for purposes of his percentage depletion allowance, must eliminate the amounts paid to the stripper. The amounts received by the stripper are in turn his "gross income from mining" upon which he computes his percentage allowance. This arrangement permits an aggregate depletion allowance upon only the gross income realized upon sale of the coal, and the revenues of the Treasury are not impaired. The Treasury's main concern lies in preventing *both* owner and stripper from claiming depletion allowances on their

full gross incomes, thus resulting (to the extent of the payments by the owner to the stripper) in the allowance of depletion in respect of the same money twice. This concern has often led to the anomalous situation where the Treasury may be arguing on behalf of the stripper in one case, and on behalf of the owner in another. Once again, the two cases arising in the Third Circuit are excellent examples. In *Mammoth* the Treasury successfully argued that the stripper had an economic interest whereas, in contrast, in the present case it contends it does not.

The effect of the foregoing upon the administration of the tax laws is obvious. Taxpayers and Treasury representatives have no guide, short of litigation, by which differences between them in this field may be administratively adjusted. The Treasury is understandably reluctant to settle with one party (either owner or stripper) because it may thereafter be met with a claim by the other without adequate standards with which to deal with it. Furthermore, taxpayers lack standards by which their own arrangements may be satisfactorily made.

In a word, this important area of the law urgently requires consideration by this Court, and the establishment of clear rules for the guidance of taxpayers and the Treasury alike. For this reason, we respectfully urge the Court to issue the writs of certiorari here sought.

CONCLUSION.

We wholeheartedly concur in the view expressed by Judge Kalodner in his dissent in *Huss:*

> "I conclude, therefore, that the taxpayers during the taxable years involved had the requisite economic interest in the coal in place. This, to me, is the result required by the decisions of the Supreme Court, the Fourth Circuit, and this Court; and our present decision is inconsistent therewith."

For the foregoing reasons, it is submitted that this petition for writs of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

Internal Revenue Code of 1939.

§ 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

* * * * * *

(m) Depletion.

In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for a depreciation of improvements, according to the peculiar conditions in each case * * *.

(n) Basis for depreciation and depletion.

The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in Section 114.

§ 114. Basis for depreciation and depletion.

* * * * * *

(b) Basis for Depletion.

* * * * * *

(4) Percentage Depletion for Coal * * *—(A) In General.

The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. * * *

(B) Definition of gross income from property.

As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include

not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment * * *.

Treasury Regulations 111.

§ 29.23(m)-1. Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements. Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. * * * An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

APPENDIX B.

Opinion of the Court Below.

Before: BIGGS, *Chief Judge*; and GOODRICH and HASTIE, *Circuit Judges*.

These are appeals by taxpayers, who are partners in a business, from a judgment of the district court denying their several claims for refunds of income taxes paid upon their respective distributable shares of certain partnership income derived from coal mining. The appellants can prevail only if the involvement of the partnership, hereinafter called Parsons, in a strip mining enterprise was such as to entitle the partners to deduct a depletion allowance, pursuant to Sections 23 (m) and 114 (b) of the Internal Revenue Code of 1939 as implemented by Treasury Regulation 111, § 29.23 (m)-1, 26 CODE FED. REG., 1949 ed., § 29.23 (m)-1, in computing partnership income from the mining operation. The problem presented is the often difficult, though familiar and recurring one of determining whether the person claiming a depletion allowance is "the owner of an economic interest in mineral deposits" within the meaning of Treasury Regulation 111, § 29.23 (m)-1.[1]

The almost simultaneous recent decisions of this court in *Commissioner of Internal Revenue v. Mammoth Coal Co.*,

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1. ". . . .

"Under such provisions [Secs. 23 (m) and 114], the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. . . . An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production." 26 CODE FED. REG., 1949 ed., § 29.23 (m)-1.

1955, 299 F.2d 535, cert. denied 352 U.S. 824, and of the Court of Appeals for the Ninth Circuit in *Usibelli v. Commissioner of Internal Revenue*, 1955, 229 F.2d 539, have gone so thoroughly into this tax problem as it arises in the context of strip mining that we shall not elaborate again the basic concepts which are discussed in those cases. It is enough to repeat that the decisions make it clear that the economic interest in coal in place which will support a percentage depletion allowance for strip mining need not amount to an estate or tenancy as understood in the law of real property. Yet, it must be something more than an independent contractor's normal right to the benefit of his bargain and the kind of "interest" which that right always gives him in the subject matter of the contract. In characterizing an asserted interest a court will be guided by the total picture revealed by the facts of the case at hand.

On this appeal the facts found by the district court are unchallenged. The Parsons firm is a contractor and over the years has engaged in road building, strip mining and the drilling of gas wells. Parsons derived the income involved in this case from strip mining conducted on land owned by the Rockhill Coal Co.

In preliminary negotiations Rockhill had proposed that Parsons undertake extensive stripping of the area in question under a detailed written contract and, to that end, Rockhill actually drafted a proposed contract. But Parsons refused to sign the agreement stating that it did not wish to be bound to a long term performance because, if opportunity should arise, it wished to return to road building. Accordingly, it was agreed that the partnership would proceed with stripping in the designated area under a terminable oral agreement. The essential provisions of that oral contract are set out in the trial findings.

The agreement defined the area to be mined but left the partnership free to work as it chose. The partnership understood that it was not obligated to mine the tract to

exhaustion. Indeed, although operations under the oral agreement were conducted from time to time over an eight year period, the tract still contained much strippable coal when Parsons terminated its operations. Some of this coal was later mined by another contractor. Moreover, it was mutually understood from the beginning, in the light of the already mentioned desire of the partnership to be free to change from stripping to road building on short notice, that either party could terminate the oral agreement on ten days notice. In this connection it was understood that after notice of termination by the landowner the partnership would still be privileged to remove and the landowner obligated to accept usable coal from which the partnership had actually removed the overburden—this constituting the major part of the stripping operation—before the notice was received.

It was agreed that the partnership should deliver the coal it mined to Rockhill's railroad cars and to no one else. In practice any coal which Rockhill rejected as unsuitable for its purposes was left in the pits as unsaleable. The parties agreed in advance upon a stipulated price per ton which Rockhill was to pay Parsons for usable coal. This price was not geared to and did not vary with the market price of coal. However, the price could be and on occasion was altered to reflect increased costs of production.

Parsons made a considerable investment in movable equipment used in the Rockhill stripping operation. Early in the taxable period the partnership committed to this job its own equipment valued at some $210,000. At the same time it was using about $130,000 worth of Rockhill equipment under a rental agreement with the landowner. As the work progressed the partnership rented an increasing amount of Rockhill equipment and used less of its own. There is no indication that the partnership equipment had utility only for this job or was specially adapted to it.

We are satisfied that what the parties agreed and what they did disclose the partnership acting only as an

ordinary independent contractor in mining the Rockhill tract. First, the matter of compensation was handled as in an ordinary contract job. The partnership had no freedom to sell or dispose of the coal to its own account. It was entitled only to an agreed price from the owner of the mining property. And since that price did not fluctuate with the market, there is nothing about the scheme of payment to indicate any interest of the contractor in the mineral. If we ask how this arrangement for payment to the partnership for its work differed from the normal payment as an independent contractor for accomplishing an agreed result, it is immediately apparent that there is no significant difference.

The other important factor on this record is the agreed duration of the enterprise. Here it is noteworthy that the partnership did not enter the job with any understanding that it would mine the tract to exhaustion, and that it did not in fact do so. Rather, it was concerned from the beginning to remain free to discontinue stripping at any time. The terminability of the agreement on short notice was an essential and significant part of the bargain, not a mere formality inserted by some cautious draftsman. The logical conclusion from all of this is that the partnership contemplated and bargained for no economic interest in the mineral it agreed to extract beyond the independent contractor's normal concern with any subject matter with which he is to work for an agreed price. True, the ten day notice could not be used to deprive Parsons of compensation for work it already had done in removing the overburden from particular coal. But this special limited right to complete work already far advanced does not destroy the character of the contract as one deliberately made terminable on very short notice.

The cases support this view of the matter. While the courts characteristically look at the entire context in deciding whether mining contractors have depletable interests in the mineral in place, the stripper usually bases his claim

upon one or both of the factors discussed above. In some circumstances the stripper's right to mine the deposit to exhaustion, or even for a rather considerable period without particular reference to exhaustion, is stressed. See *Commissioner of Internal Revenue v. Mammoth Coal Co., supra; Stilwell v. United States,* 4th Cir., 1957, 250 F.2d 736; *Winfield Mining & Contracting Co.,* 1954, 13 TCM 571; *James Ruston,* 1952, 19 T.C. 284; *cf.* G.C.M. 26290, 1950-1 CUM. BULL. 42. In others the fact that the stripper's income from the mining operation varies in accordance with the market price of the mineral makes his claim of depletable interest persuasive. See *Commissioner of Internal Revenue v. Gregory Run Coal Co.,* 4th Cir. 1954, 212 F.2d 52, *cert. denied,* 348 U.S. 828 (Vincent-Swaney contract); *Virginia B. Coal Co.,* 1956, 25 T.C. 899; *Paul E. Barry, Inc.,* 1955, 14 TCM 37; *Winfield Mining & Contracting Co., supra; James Ruston, supra.* But see *C. A. Hughes & Co.,* 1955, 14 TCM 172. But unless some such special circumstance appears, differentiating the arrangement from the ordinary contract job, there is analytically no basis upon which the stripper, who has no conventional property in the mineral, can claim a depletable interest therein.

Appellants attach much significance to recent borderline cases in which the Court of Appeals for the Fourth Circuit has found that contractors engaged in strip mining on land of others were entitled to depletion allowances. See *Stilwell v. United States, supra; Commissioner of Internal Revenue v. Gregory Run Coal Co., supra; Weirton Ice & Coal Supply Co. v. Commissioner of Internal Revenue,* 4th Cir. 1956, 231 F.2d 531; *Commissioner of Internal Revenue v. Hamill Coal Corp.,* 4th Cir. 1956, 239 F. 2d. 347. That court has certainly gone as far as any other in recognizing depletable interests in strippers. But in the cited Fourth Circuit decisions we find repeated emphasis upon the court's factual conclusion that the real understanding of the parties was that the strip miners would be allowed to exhaust the mineral, or at least to continue stripping oper-

ations for a very substantial time. Only in one of the arrangements considered in *Commissioner of Internal Revenue v. Gregory Run Coal Co., supra,* does this factor seem to have been absent. And there the owner and the strip miner had formalized their relationship in an agreement terming the strip mining project "this joint adventure." How much weight the court accorded this indication of the way the parties themselves viewed their relationship, we do not know. Perhaps no more can be said than that distinguishing facts usually prevent reasoning by analogy from being very helpful in borderline cases. In any event, we think the reasoning of the Fourth Circuit cases requires the stripper to marshal more significant indicia of interest in the mineral than the present record will yield.

One other point deserves separate mention. In these mining cases the allowance of a percentage depletion deduction from gross income for tax purposes is premised on the conception that a tax free recovery of capital actually invested in a wasting mineral deposit is fair. See *Commissioner of Internal Revenue v. Southwest Exploration Co.,* 1956, 350 U.S. 308, 312. The commitment of capital as an investment in the exploitation of a given mineral deposit must be real and unequivocal. Otherwise, mining contractors, like contractors generally, must look to "receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working." See *Usibelli v. Commissioner of Internal Revenue, supra,* 229 F.2d at 541.

Here the only thing set up as a capital investment in the Rockhill coal deposits is Parsons' purchase of a considerable quantity of movable equipment, accompanied by the rental of other equipment from Rockhill. There has been no showing that this equipment was specially adapted to this job or that it would not be suitable thereafter for such other undertakings as constituted the normal and familiar business of this contractor. Thus, quite apart from

considerations relating to compensation and the terminability of the contract, it is very doubtful whether investment in equipment of general utility in a contractor's business is the type of capital expenditure which can properly be found to constitute an investment in a particular mineral deposit which the contractor has undertaken to work.

For these reasons we agree with the district court that the tax refund claims in suit are not well founded.

The judgment will be affirmed.

APPENDIX C.

Judgments of the Court Below.

No. 12,299.

Present: BIGGS, *Chief Judge,* GOODRICH and HASTIE, *Circuit Judges*

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958

No. 12,300.

Present: BIGGS, *Chief Judge* and GOODRICH and HASTIE, *Circuit Judges.*

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958

No. 12,301.

Present: BIGGS, *Chief Judge* and GOODRICH and HASTIE, *Circuit Judges.*

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958.

APPENDIX D.

Opinion of the Court Below on Petition for Rehearing.

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

PER CURIAM:

This petition for rehearing raises no point of substance that has not already been considered and decided against the petitioner. Accordingly, the petition is denied.

KALODNER, *Circuit Judge,* dissenting.

I am of the opinion that a rehearing should be granted, and the judgment of the district court reversed.

This result is required for the reasons I have given in my dissenting opinion in the Huss cases.

The taxpayers here, as in the Huss cases, were granted an exclusive right to remove all the merchantable coal in place in the reserved or leased area. They had a right of control over production of the mineral in place which gives rise to the economic interest necessary for the depletion allowance. Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 29, 32 (1946). All the coal involved was produced during the existence of this interest. The fact that such interest might have been brought to an end some day in the future is not a relevant consideration.

APPENDIX E.

Order Sur Petition for Rehearing.

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

After due consideration the petition for rehearing in the above-entitled cases is hereby denied.

Attest:

IDA O. CRESKOFF
Clerk

Dated:

May 29, 1958

APPENDIX F.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,315

No. 12,317

No. 12,319

GEORGE HUSS,
Appellant in No. 12,315

RUSSELL HUSS,
Appellant in No. 12,317

WESLEY HUSS,
Appellant in No. 12,319

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,
FIRST DISTRICT OF PENNSYLVANIA

SUR PETITION FOR REHEARING

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

Opinion of the Court

(Filed May 29, 1958)

• • •

KALODNER, *Circuit Judge,* dissenting.

I would grant the petition for rehearing. Further, on rehearing I would reverse the judgment of the district court on the principal issue involved—the existence of an economic interest.

The Supreme Court has charted the course and the law in cases of this type. Only recently it stated, firmly and concisely, that a taxpayer is entitled to the depletion deduction "where he has: (1) 'acquired, by investment, any interest in the oil in place', and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital' ". Commissioner v. Southwest Exploration Co., 350 U.S. 308, 314 (1956).

"These two factors usually considered together", said the Supreme Court in the Southwest Exploration case, "constitute the requirement of 'an economic interest.' "

Nothing was said by the Supreme Court in that case on the score as to the impact of a right of termination of a contract creating an economic interest on the existence of that interest in the first place. Nor has the Supreme Court said so in any other case. We did not consider nor did we pass upon this question in Commissioner v. Mammoth Coal, 229 F.2d 255 (1955). Nor has any other appellate court done so except the Fourth Circuit. That Circuit, however, has explicitly ruled that a right of termination does not destroy an economic interest which existed prior to its exercise. It did so in two cases: Weirton Ice and Coal Supply Co. v. Commissioner, 231 F.2d 531, 533 (1956) and Commissioner v. Hamill Coal Corp., 239 F.2d 347 (1956).

In Weirton it was said (p. 535):

> "It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all the taxable years."

In Hamill, the contract (entered into in 1944) was to continue for one year and from year to year thereafter with the right of either party to terminate it at any time upon 90 days' written notice. The contract was terminated in 1947 by mutual agreement "after Daniel [the stripper] had removed substantially all the coal with an overburden of less than 40 feet." (p. 349).

In Weirton the decision does not disclose when mining operation ceased or whether the stripper ever mined to exhaustion. In Hamill, however, the record discloses that subsequent to termination the owner of the mine actually mined some 90,000 tons of coal.

In the instant case it is undisputed that the stripper (taxpayers) mined to exhaustion and that the contracts were terminated by mutual agreement after such exhaustion so that the factual situation here is much stronger than in either Weirton or Hamill.

I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right.

It is not necessary, however, that I go as far along the course stated in the decision of the instant case. The record here discloses that the termination clause was included in the contract as a precaution on the part of the

owner to protect itself from possible difficulties with an incompetent stripper.[1] It may be noted parenthetically that in the opinion sought to be reconsidered it was erroneously stated "We are not told the reason for including this cancellation clause."

Assuredly, prior to the exercise of the termination clause, taxpayers here "had an economic interest in the oil [coal] in place through its [their] control over extraction." Burton-Sutton Oil Co., Inc. v. Commissioner, 328 U.S. 25, 34 (1946). That control, moreover, actually existed, as already said, until the property was mined to exhaustion. Further, as stated in Burton-Sutton Oil Co. "Depletion depends only upon production".

It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312.

There is no room for doubt that the taxpayers had the requisite control over production, for under the contracts, the Coal Company gave to taxpayers the exclusive right to mine all of the merchantable coal in place in the leased area. That such right might have been brought to an end does not affect the present fact that the economic interest existed.

There is also no room for doubt that the taxpayers depended solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including, but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operation profitable.

Until now, every appellate decision in this type of case, including our own decision in Commissioner v. Mammoth

1. Russell Huss testified (p. 60 N. T.) that the termination clause "was put in there in a form contract so as if they got hold of a contractor who was not reputable, who wouldn't live up to the contract, they could put him off the property without court action."

Coal Co., supra, has held that there is no requirement that the stripper must assume the risks of the ultimate market. To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, Commissioner v. Southwest Exploration Co., 350 U.S. at page 314, that the taxpayer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do.

Although we said, in Commissioner v. Mammoth Coal Co., 229 F.2d at page 537, that "The facts in each case determine the result", I do not regard such declaration as an admission that the criteria to be applied are too vague to do so on other than the basis of "the reasonable man". To the facts must be applied statute and the specific rules pronounced by the Supreme Court in the interpretation of it. That is the teaching of Commissioner v. Southwest Exploration Co., supra.

I conclude, therefore, that the taxpayers during the taxable years involved had the requisite economic interest in the coal in place. This, to me, is the result required by the decisions of the Supreme Court, the Fourth Circuit, and this Court; and our present decision is inconsistent therewith.

Accordingly, I would grant rehearing and reverse the judgments of the district court.

FILE COPY

No. 218

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IN THE

Supreme Court of the United States

October Term, 1958

EMORY W. PARSONS AND ERMA M. PARSONS,
Petitioners, No. .....

HOWARD H. PARSONS AND MARTHA PARSONS,
Petitioners, No. .....

LAWRENCE H. PARSONS AND GRACE E. PARSONS,
Petitioners, No. .....

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

BRIEF AMICUS CURIAE IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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GCM 26250

IN THE

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FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

BRIEF AMICUS CURIAE IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Estate of John Schumacher, as amicus curiae, with the consent of petitioners and respondent (through the Solicitor General), hereby petitions the Court in support of the Petition For Writs Of Certiorari of the above-named petitioners to review the judgments of the United States Court of Appeals for the Third Circuit in the above-captioned cases.

INTEREST OF AMICUS CURIAE

The issue here involved—whether a strip miner of coal has an economic interest and is therefore entitled to depletion on his income for mining—is the same issue involved in a series of cases now pending in the District Court of the United States for the Eastern District of Pennsylvania: *Estate of John Schumacher* v. *U. S.*,

Docket Nos. 13,191 and 13,189; *Estate of Henry E. Schultz* v. *U. S.*, Docket Nos. 13,190 and 13,192; and *Robert Rowland* v. *U. S.*, Docket No. 14,625. In addition the listed taxpayers (all of whom are represented by undersigned counsel) have the same issue in other tax years involved in other cases now pending, in which refund claims have been filed and rejected and suit about to be filed, probably in the United States Court of Claims.

QUESTION PRESENTED *

Is a strip miner of coal entitled to a share of the percentage depletion allowance where he mines the coal pursuant to a contract giving him the exclusive right to extract coal from a particular property and where he is paid only upon the discovery and extraction of the coal, or does he lose this right because his pay is not dependent upon the price at which someone else ultimately sells the coal and because the other party to the contract has the right to terminate the contract?

STATEMENT

There is no dispute that the petitioners here realized income from the conduct of strip mining operations for which they were paid by contract only for the coal actually discovered, uncovered, extracted and delivered. Nonetheless the Court below denied depletion to the strip miners on three grounds. **First**: that the right to depletion is contingent upon the "commitment of capital as an investment in the exploitation of a given mineral deposit [which commitment of capital] must be real and unequivocal", and that this requirement is not satisfied where the strip miner's only "investment [is] in equip-

* The same question is presented in the three cases of *Huss* v. *Commissioner*, Nos. 12,315, 12,317 and 12,319, decided by the Court below on the same day on which the present cases were decided. Counsel understands that the taxpayers there propose to file a petition for writ of certiorari.

ment of general utility". **Second**: since the strip miner was "entitled only to an agreed price" which "did not fluctuate with the market, there is nothing about the scheme of agreement to indicate any interest of the contractor in the mineral". **Third**: since the contract was terminable on 10-days' notice by either party, the "logical conclusion . . . is that the partnership [the strip miner] contemplated and bargained for no economic interest in the mineral".

a. The first of these grounds is in direct conflict with this Court's decision in *Commissioner* v. *Southwest Exploration Company*, 350 U.S. 308 (1956), and with every decision * allowing any strip miner to deduct depletion.

b. The second basis of the decisions below is in direct conflict with (1) three decisions of the Fourth Circuit Court of Appeals,** (2) the earlier decision of the Court below in *Commissioner* v. *Mammoth Coal Company*, 229 F.2d 535 (3d Cir. 1955), and (3) the government's position as set forth in its brief in the Court below.

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* See, for example, in addition to the decisions of the Third and Fourth Circuit Courts of Appeals cited in the body of the petition, *Paul E. Barry, Inc.*, 14 T.C.M. 37 (1955); *Helen C. Brown*, 22 T.C. 58 (1954) acq. 1954-2 Int. Rev. Cum. Bull. 3; *Winfield Mining and Contracting Co.*, 13 T.C.M. 571 (1954); *James Ruston*, 19 T.C. 284 (1952), acq. 1953-2 Int. Rev. Cum. Bull. 6.

** In *Weirton Ice and Coal Supply Company* v. *Commissioner*, 231 F.2d 531 (1956); *Commissioner* v. *Hamill Coal Corporation*, 239 F.2d 347 (1956); and *Commissioner* v. *Gregory Run Coal Company*, 212 F.2d 52 (1954). The only other appellate court decision on the question is *Usibelli* v. *Commissioner*, 229 F.2d 539 (9th Cir. 1955) which the Fourth Circuit in *Weirton*, *supra*, distinguished on the grounds that the strip miner's contract was a one-year contract for the U.S. Army which contracted to pay a certain sum for services rendered so that the taxpayer did not depend upon the severance of the coal for his income. If this distinction is not valid, *Usibelli* might be considered as supporting the decisions below, in which event both sets of decisions are in conflict with the cited decisions of the Fourth Circuit.

c. The third ground relied upon by the Court below conflicts with the decisions of the Fourth Circuit Court of Appeals referred to in the preceding paragraph.

d. The decisions below make it difficult, if not impossible, for the participants in the strip mining business to understand their respective tax rights and liabilities and to plan their strip mining operations in an orderly business-like way.

REASONS FOR GRANTING THE WRITS

1. The decisions below are in direct conflict with the decisions of this Court in *Commissioner* v. *Southwest Exploration Company* and in other cases outlining the fundamental aspects of depletion.

a. The conflict with *Southwest Exploration Company* follows from the stress laid by the Court below on the type of capital investment required to support the depletion allowance. That Court said that the investment in machinery suitable for other than stripping purposes does not constitute the kind of investment needed to warrant the allowance of depletion (with the implication that the purchase of one-purpose machinery might suffice). This point is without meaning here. The type of investment talked of with regard to depletion has nothing to do with machinery of any kind or the expenditure of money to buy a lease or fee or the outlay of any sum of money for any such purpose. As this Court said in the *Southwest Exploration Company* case, (350 U.S. at 312), depletion "continues so long as minerals are extracted, and even though no money was actually invested in the deposit".

The "capital investment" talked of here is synonomous with "economic interest": the investment to be recovered is the taxpayer's economic interest in the coal in place and to be extracted. Were this not so, no stripper would ever have the kind of investment which would support

the depletion allowance. If the law required a cash outlay for the purchase of "something depletable", no strip miner would ever be entitled to depletion.

The opinion of the Court below on this point conflicts with every decision allowing depletion to a strip miner, as well as with this Court's decision in *Southwest Exploration Company.*

b. The many other decisions of this Court with which the decisions below conflict are best typified by *Palmer* v. *Bender,* 287 U.S. 551, 557 (1933). In its decision in *Southwest Exploration Company,* this Court describes as follows the two basic requirements for depletion laid down in *Palmer* v. *Bender*:

> " . . . a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship income derived from the extraction of the oil, to which he must look for a return of his capital."

The Court below either ignored these rules or forgot that both of them are satisfied here. The strip miner here acquired the exclusive right to strip mine coal from a designated area; he committed his assets and his entire business operation to finding and extracting the coal; he assumed all the risks inherent in finding and getting the coal out of the ground; and he was paid only if he found, extracted, and delivered the coal as per contract.

The denial of depletion to the strip miner under these circumstances (because of what really are secondary or extraneous circumstances) ignores the basic concept of depletion as that concept has been outlined by this Court, in *Palmer* v. *Bender,* and in such cases as *Burton-Sutton Oil Company* v. *Commissioner,* 328 U.S. 25 (1946).

2. The decisions below are in direct conflict with the decisions of the Fourth Circuit Court of Appeals.

This is true in two fundamental respects.

a. The first concerns the significance awarded by the Court below to the fact that the strip miner was paid a

fixed price per ton which did not fluctuate with the price at which the coal company sold the coal on the open market. The Fourth Circuit Court has held in a number of cases that the method of payment has nothing to do with the right to depletion. *Commissioner* v. *Gregory Run Coal Company,* (the first appellate court decision on the question), *Weirton* and *Hamill,* all *supra.* Those cases hold in effect that if strip miners A and B have identical rights, which would entitle them to depletion, the fact that A is paid a fixed price per ton for the identical mining operations can not operate to produce a tax result for him directly opposite to what is applicable to B just because the latter's pay fluctuates with the price of the coal on the coal market.

The method of payment to the strip miner has no bearing on the question of the existence in the first instance of an "economic interest", on the question of the federal income tax significance of the right to extract coal from particular property, when the extractor is paid, if, and only if, and when, the coal is extracted, thereby assuming all the risks inherent in finding and getting the coal out of the ground.

We urge that this fundamental proposition in no way depends upon whether the strip miner's economic interest in the coal continues *after* it has been discovered and mined and turned over to the coal company or anyone else for sale.

b. The second fundamental respect in which the decisions of the Court below conflict with the Fourth Circuit decisions concerns the termination clause. In the *Weirton* case (231 F. 2d at 635), that Court stated:

> "It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved Weirton actually mined the coal during all of the taxable years."

The Fourth Circuit reached the same conclusion in the *Gregory Run* and *Hamill* cases despite the right of the coal company in those cases to terminate on 30 and 90 days' notice respectively.*

We urge that these cases and the dissent below are sound. The contract power to terminate the stripper's economic interest has nothing to do with the existence of that right in the first instance. The power of termination is relevant only if it is actually exercised and then only because it may affect gross income from mining which thus in turn affects the amount of depletion allowance. But these quantitative considerations are of no greater moment here, in relation to the basic question of the *right* to depletion, than are such things as the cost and life of an asset in relation to the existence of the *right* to (as opposed to the amount of) depreciation. Obviously, the lower the cost and the longer the life of an asset, the smaller the amount of the annual deduction for depreciation. But the *right* to any deduction at all exists even if the asset cost $10.00 and has a life of ten years. So here: the cancellation of a contract or the reduction of the tonnage to be mined may reduce the amount of the income from mining and therefore necessarily the amount of the deduction for depletion. But these *quantitative* considerations have no other relevance. They cannot affect the basic, initial question of whether there is an economic interest to start with.

3. The decisions of the Court below conflict with its own earlier decision in *Commissioner* v. *Mammoth Coal Company*.

---

* Cf. *Stilwell* v. *U.S.* 250 F.2d 736 (4th Cir. 1957) where, after citing with approval its three earlier decisions listed above, the Fourth Circuit held that there was no right of termination, but then went on, unnecessarily, to use language—in one sentence—which could indicate some confusion as to the significance of terminability. The Court below made no point of this and in fact included *Stilwell* in the same category with the other three Fourth Circuit decisions which the Court below described as "recent borderline cases".

In that case the Third Circuit Court of Appeals allowed a strip miner to deduct depletion even though he was paid a fixed price per ton—precisely as here. The Court there said (229 F. 2d at 538):

> "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the . . . [coal company] should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

The decisions below in the instant case thus necessarily emasculate the earlier opinion of the same court in *Mammoth*. As already indicated, they thus conflict necessarily also with the Fourth Circuit decisions cited above.

4. The decisions below go beyond the point urged by the Government in its brief below.

a. This is true with regard to the method of payment point. In its brief below (page 18), the Government said:

> "When an agreement defines a particular area in which a strip miner is to work and grants to him the exclusive right to mine that area until the mineral supply is exhausted, and provides that all coal mined is to be delivered to the land owner *in return for a stated amount per ton delivered*, it is our position that the miner's relationship with the mineral in place is such as to entitle him to an allowance for depletion; the existence of his interest is coterminous with the existence of the mineral deposit and as each ton of coal is extracted that interest necessarily becomes less valuable." (emphasis added)

The use by the Court below of this factor to support a conclusion opposite to (a) its own decision in *Mammoth*, (b) the Fourth Circuit decisions in *Gregory Run*, *Hamill* and *Weirton*, and (c) the government's brief below, is a source of confusion to be clarified.

b. This is true also with regard to the reliance by the Court below on the need for investment in the form of a

cash outlay for certain type of equipment. We do not believe that the government urged that argument and do not believe that the government's policy in administering the applicable provisions of the Internal Revenue Code includes any such argument. On the contrary, the government has acquiesced in several decisions giving a share of the depletion allowance to strip miners. See for example the *Brown* and *Ruston* cases, *supra*.

5. This is an important question in the mining industry which warrants consideration by this Court to resolve the various conflicts outlined above.

As the government stated in General Counsel's Memorandum 26290, 1950-1 Internal Revenue Bulletin, 42, 43:

> "In the mountainous coal fields of the East there are few large areas which can be mined by removing the overburden, and the owner or lessee of the property does not ordinarily buy the necessary stripping equipment. Accordingly, in the case of small tracts of coal land from which the mineral cannot be economically removed by underground mining, as well as in situations in which a fringe of coal near the surface cannot be satisfactorily extracted by underground methods, the contractor who owns stripping equipment has solved a problem of the industry."

It is believed that beside the petitioners here and in the *Huss* cases, and amicus curaie, there are many other taxpayers engaged in the business of strip mining under sufficiently similar circumstances to make it a matter of great concern to secure clarification of the method of allocating depletion between the strip miners and the coal companies. Needless to say, the coal companies with whom these stripping contracts are negotiated have the same interest. And of course the Internal Revenue Service itself needs guidance in determining and applying a policy as to which cases are properly subject to settlement and which are to be litigated.

It is no answer to say that it is a question of fact in each case. As the dissenting judge below pointed out, "I do not regard . . . the criteria to be applied . . . [as] too vague to do so on other than the basis of 'the reasonable man'. To the facts must be applied statute and the specific rules pronounced by the Supreme Court in the interpretation of it. That is the teaching of *Commissioner* v. *Southwest Exploration Co.*" The decisions below are founded upon three keystone points on the basis of which the Court below denied depletion to a strip miner. We respectfully urge that the Court below erred in the significance it gave to each of those three factors. That error conflicts not only with numerous court decisions, as outlined above, but also with the underlying concepts of depletion in the coal strip mining area.

CONCLUSION

As explicitly set forth in the dissent below on the petition for rehearing, the decisions below are in direct conflict with the decisions of this Court, of the Fourth Circuit Court of Appeals, and of the Court below, thereby confusing important issues which only this Court can clarify. For these reasons, it is respectfully submitted that the Petition For Writs Of Certiorari be granted.

Respectfully submitted,

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Nos. 219 and 315

In the Supreme Court of the United States

OCTOBER TERM, 1958

EMORY W. PARSONS, ERMA M. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

GEORGE HUSS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAD REVENUE FOR THE FIEST DISTRICT OF PENNSYLVANIA

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Third Circuit

---

MEMORANDUM FOR THE RESPONDENT

LEE RANKIN,
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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

No. 305

GEORGE HUSS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Third Circuit

---

MEMORANDUM FOR THE RESPONDENT

The issue presented in these cases is whether the taxpayers who are members of partnerships which, under contract with the owners of coal lands, engaged in the business of strip mining coal for the owners

of the land in return for a compensation based upon the tonnage of coal extracted and delivered to the owners, acquired, by reason of such contracts, an economic interest in the coal in place so as to entitle the taxpayers to an allowance for depletion under Sections 23(m) and 114(b) of the Internal Revenue Code of 1939. The District Court and Court of Appeals held that the taxpayers did not acquire the requisite economic interest and were not entitled to the claimed deduction. Although the Government believes that the courts below correctly decided the issue in both cases, we do not oppose the granting of the petitions for certiorari for the following reasons:

1. The question presented is one which appears to be arising with increasing frequency. To date, eight cases, including the instant cases, have been presented to the Courts of Appeals.[1] These cases have reached varying results, some allowing the strip mining contractor the claimed depletion (see *e.g. Commissioner* v. *Gregory Run Coal Co.*, 212 F. 2d 52 (C.A. 4th), certiorari denied, 348 U.S. 828; *Weirton Ice & Coal Sup. Co.* v. *Commissioner*, 231 F. 2d 531 (C.A. 4th)), while others (such as the instant cases and *Usibelli* v. *Commissioner*, 229 F. 2d 539 (C.A. 9th)) hold that

[1] Cases other than the cases at bar are: *Commissioner* v. *Gregory Run Coal Co.*, 212 F. 2d 52 (C.A. 4th), certiorari denied, 348 U.S. 828; *Commissioner* v. *Mammoth Coal Co.*, 229 F. 2d 535 (C.A. 3d), rehearing denied, 229 F. 2d 539, certiorari denied, 352 U.S. 824; *Usibelli* v. *Commissioner*, 229 F. 2d 539 (C.A. 9th); *Weirton Ice & Coal Sup. Co.* v. *Commissioner*, 231 F. 2d 531 (C.A. 4th); *Commissioner* v. *Hamill Coal Corp.*, 239 F. 2d 347 (C.A. 4th); *Stilwell* v. *United States*, 250 F. 2d 736 (C.A. 4th).

the contractors did not acquire the necessary economic interest. Most of the cases have arisen in the Third and Fourth Circuits, and to some extent, at least, these courts appear to have taken a different view as to the relevance of the fact that the strip miner's contract is terminable on short notice at the will of the owner of the coal lands, a factor which the Internal Revenue Service (see G.C.M. 26290, 1950-1 Cum. Bull. 42) has considered to be highly significant. Compare the instant cases with *Weirton Ice & Coal Sup. Co.* v. *Commissioner*, *supra*. This divergence of approach apparently led the court below to state, in consideration of the petition for rehearing in the *Huss* case (Pet. 26): "We are not sure what * * * [the Fourth Circuit] would do in reviewing a decision against the stripper on the facts of our case." But see *Stilwell* v. *United States*, 250 F. 2d 736, 739. Although each of the decided cases involves a different contractual arrangement, there does appear to be a conflict in approach between the Third and Fourth Circuits, unless the latter court's most recent decision in *Stilwell* v. *United States*, *supra*, is construed as a reversal of position by that court.

2. It is important in the administration of the revenue laws that the issue presented be finally resolved. The depletion allowance is one that must be "equitably apportioned between the lessor and lessee" of mineral property. Section 23(m) of the Internal Revenue Code of 1939. Percentage depletion is allowed, under Section 114(b) of the Code, on the "gross income from the property" and, to the extent that the strip miner is allowed a depletion deduction, there

must be a corresponding disallowance of the deduction to the owner of the property. See *Commissioner v. Southwest Expl. Co.*, 350 U.S. 308, 309. Thus, uncertainty as to whether a strip mining contractor is entitled to the deduction makes administration of the law in this respect difficult.

Accordingly, we agree that review by this Court is warranted and that the petitions for certiorari should be granted.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

SEPTEMBER, 1958.

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IN THE

Supreme Court of the United States

October Term, 1958.

No. 218.

EMORY W. PARSONS, ERMA M. PARSONS, et al.,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE PETITIONERS.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1958.

No. 218.

EMORY W. PARSONS, ERMA M. PARSONS, ET AL.,
Petitioners,

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE PETITIONERS.

OPINIONS BELOW.

Three cases, brought individually by three partners and their wives for refund of Federal income taxes, are before the Court in this proceeding. Since the cases involve identical issues, they were consolidated for trial before the United States District Court for the Eastern District of Pennsylvania and, upon appeal, were consolidated for hearing before the Court of Appeals. The findings of fact and opinion of the District Court (R. 7-29), which were not reported officially, are reported unofficially at 52 AFTR 1661. The opinions of the Court of Appeals affirming the District Court (R. 33-9) and denying petition for rehearing (R. 46-7) are reported at 255 F. 2d 595. Judge Kalodner dissented from the Court of Appeals' denial of the petition for rehearing, stating that his views are expressed at length in his dissenting opinion rendered in connection with the

Court of Appeals' denial of a petition for rehearing in *Huss v. Smith*.[1] Judge Kalodner's dissenting opinion in the *Huss* case, which was decided against the taxpayers in that case on the same day as the present case, is set forth in full in Appendix A, *infra*, page 23. This Court has granted a writ of certiorari in the *Huss* case, and has consolidated that case for argument with the present case.

JURISDICTION.

The judgments of the Court of Appeals (R. 39-41) were entered on March 27, 1958. The order of the Court of Appeals denying petition for rehearing (R. 47) was entered on May 29, 1958. The petition for a writ of certiorari was filed on July 25, 1958, and was granted on October 13, 1958 (R. 48). The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code, 28 U. S. C. § 1254(1).

STATUTES.

In sum, the statutory provisions here involved provide for an income tax deduction for percentage depletion, in the case of coal mines, of 5% of the gross income received by a taxpayer from mining.[2]

The statutory provisions are Sections 23(m), 23(n) and 114(b)(4) of the Internal Revenue Code of 1939, 26 U. S. C. §§ 23(m), (n) and 114(b)(4). They are printed in Appendix B, *infra*, page 23.[3] The regulations involved are Treasury Regulations 111, 26 *Code Fed. Regs.* § 29.23(m)-1 (1949). They are printed in Appendix B, *infra*, page 28.

1. The opinions of the Court of Appeals in the *Huss* case affirming the District Court and denying petition for rehearing are reported at 255 F. 2d 599.

2. The taxable years in issue are 1945 through 1949. In the Revenue Act of 1951, the percentage rate for coal mines was increased from 5% to 10%, the current rate.

3. The provisions of the Internal Revenue Code cited are those applicable to the taxable years here involved. There has been no substantial change in those provisions affecting the question presented by this case. Compare Sections 611(a) and 613 of the Internal Revenue Code of 1954, 26 U. S. C. §§ 611(a), 613.

QUESTION PRESENTED.

A partnership ("miner") agreed with a landowner to prospect for and strip mine coal from his land, the entire cost of the operation to be borne by the miner. The owner agreed to pay the miner a stated price per ton for marketable coal which the miner discovered and extracted. The parties agreed that either could terminate the arrangement on ten days' notice, but in such event the miner would have the indefeasible right to remove and receive payment for all coal uncovered to the date of termination. After eight years of continuous stripping the arrangement was terminated by the miner.

The question is whether the Court of Appeals erred in holding that the miner had no economic interest in the coal it mined and was therefore entitled to no percentage depletion deduction, because its contract might have been terminated by the landowner and it was paid a stated price per ton of coal. It so held notwithstanding the fact (which the dissent below considered controlling) that the miner had the exclusive right to mine to exhaustion all coal uncovered by it, bore the entire cost of the enterprise, and was paid only for marketable coal discovered and delivered.

The United States (present here through a former Collector of Internal Revenue) is essentially a stakeholder in this proceeding. There is no dispute that an aggregate percentage depletion deduction is allowable, measured by the gross income derived from the property. The real question, therefore, is whether the landowner is entitled to the entire allowance or whether a portion of it should be allowed to the miner. Should the Court answer this question in favor of the miner, the owner would be required, in computing its depletion, to exclude from its gross income the amount paid to the miner. The miner in turn would measure its deduction by the amounts received from the owner. Thus, the decision in this case will determine only how the aggregate depletion allowance is to be shared.[4]

4. Similar considerations were present in *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308 (1956), where both parties claiming the depletion allowance were before the Court at one time.

STATEMENT OF THE CASE.

The essential facts of this case may be summarized as follows:

During the taxable years in issue petitioners Emory W. Parsons, Howard H. Parsons and Lawrence H. Parsons were members of a partnership ("Parsons") [5] engaged in strip mining bituminous coal in Pennsylvania (R. 8, 11).

Petitioners brought suit upon rejected claims for refund of Federal income taxes. These claims were based upon the right of the partnership to a deduction for percentage depletion on amounts received by it during the taxable years for coal stripped under an oral agreement with Rockhill Coal Company ("Rockhill") (R. 8-11).

In March, 1942 Parsons and Rockhill entered into an oral salvage agreement under which Parsons agreed to strip mine land belonging to Rockhill at its own expense, and Rockhill agreed to pay a stated price per ton for marketable coal delivered (R. 13-15).[6] Under a salvage contract the stripper bears the entire cost of the operation, including normal operating expenses such as payroll, equipment rental, fuel and explosives, as well as the cost of grading and building roads and preparing tipple sites. He is paid, however, only if he is successful in discovering and extracting marketable coal. The landowner is required to pay only for marketable coal as it is delivered to him by the stripper (R. 15-18).

---

5. The taxable years in issue are 1945 through 1949. Lawrence H. Parsons withdrew from the partnership effective December 31, 1948, and accordingly filed no refund claim for 1949. Emory W. Parsons and Howard H. Parsons continued the partnership during 1949.

6. According to the oral agreement, changes in the stated price per ton were to reflect only increases in wage or labor costs, but Rockhill also granted increases to compensate Parsons for increases in the cost of materials and explosives. These additional increases were in the nature of new oral agreements (R. 15-16).

Parsons' agreement was terminable by either party upon ten days' notice. It was also agreed that if Rockhill terminated the contract, Parsons had the right to remove and be paid for all uncovered coal, even though the removal required more than ten days (R. 13-14). Rockhill never exercised its right of termination, and Parsons continued to strip mine coal on Rockhill land until the fall of 1950 (R. 19, 24).

Parsons had the exclusive right, subject only to Rockhill's right of termination, to strip areas allocated to it (R. 15). These areas were selected by Rockhill's engineering department after consultation with Parsons and, generally, prospecting was sixty per cent successful (R. 18-19). On August 1, 1950, Parsons gave Rockhill notice that it intended to cease its operations, and Rockhill agreed that thirty days' notice would be satisfactory. Thereafter Parsons continued to strip mine coal that had been cleared of overburden until September 5, 1950, when no coal was left uncovered (R. 24).

The value of Parsons' equipment used in the operation ranged from $60,000 in 1943 to $250,000 in 1947. When Parsons ceased stripping on Rockhill land in 1950 it was utilizing equipment having a total value of $495,000, of which $125,000 was represented by its own equipment, and the balance by equipment leased from Rockhill (R. 21-22). Subject only to Rockhill's right of termination, Parsons controlled the size of the operation and the amount of coal mined (R. 14-15).

SUMMARY OF ARGUMENT.

I.

Parsons' right to depletion depends upon whether it acquired an economic interest in the coal in place. It did so under the decisions of this Court if (1) it acquired, by investment, an interest in the coal; (2) its income was dependent solely upon production; and (3) its interest was such that it declined in value as the coal was extracted.

The foregoing tests are met in the present case because (1) Parsons contributed to the enterprise its organization, know-how and equipment as operator, and by this investment acquired the right to mine the coal; (2) it received payment only for coal mined and delivered; and (3) the value of its right to mine coal declined as the coal deposit was depleted and less coal remained from which income could be realized.

As an entrepreneur assuming the risk of discovering and extracting a natural resource, by a contract under which it received no payment until it extracted and delivered marketable coal, Parsons is squarely within the class to which Congress intended depletion to be allowed.

II.

In denying the depletion deduction the Court of Appeals relied upon two factors: (1) Parsons' interest was terminable by either party; and (2) Parsons was paid a stated price per ton, irrespective of the market price. It mentioned a third factor: that Parsons' equipment was depreciable and suitable for other uses. None of these forecloses the existence of an economic interest.

1. Parsons had a valuable interest in the coal which Rockhill's right to terminate did not eliminate. The right to terminate in the future as to coal as yet undiscovered could not affect the existence of Parsons' economic interest in coal actually mined. In fact, as to coal uncovered Parsons' rights were nonterminable.

2. The depletion deduction is intended to compensate those who bear the risk of discovering natural resources. It is unnecessary that they also assume the risk of the market, a risk inherent in any enterprise conducted for profit and unrelated to production.

3. The third factor fails to comprehend the nature of Parsons' investment—the unlimited commitment of its entire organization as the operator, with the attendant financial risks. The Court below overlooked the elementary fact that all equipment used in developing natural resources (whether oil, gas or any mineral) is depreciable. If any other type of investment were required, no stripper operating under a stripping contract would have the requisite capital investment to support depletion.

ARGUMENT.

I.

Under the Principles Enunciated by This Court, Parsons Is Entitled to Depletion Deductions With Respect to Amounts Received for Coal Delivered to Rockhill During the Taxable Years in Question.

A. Introductory.

The sole issue in this case is whether the Court of Appeals erred in holding that Parsons, in computing its net income under the Internal Revenue Code,[7] was not entitled to deduct percentage depletion with respect to amounts received by it from Rockhill in payment for coal mined by it and delivered to Rockhill during the taxable years in question. Decision of this issue turns upon whether Parsons had an economic interest in the coal in place. *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599 (1946).

Although the right of a coal stripper to depletion has been the subject of extensive litigation in the lower courts, this Court has not passed upon the question. However, under principles announced by this Court in cases pertaining to depletion of oil and gas interests, it is now well established that a coal stripper can have an economic interest in coal sufficient to support a depletion allowance. The Courts of Appeals for both the Third and Fourth Circuits have so held where a miner was stripping coal under a contract on land belonging to another. *Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535 (3d Cir. 1955), *cert. denied*, 352 U. S. 824 (1956); *Commissioner v. Gregory Run Coal Co.*, 212 F. 2d 52 (4th Cir. 1954), *cert. denied*, 348 U. S. 828 (1954). As the Fourth Circuit said in the *Gregory Run* case, 212 F. 2d at 61:

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7. Sections 23(m), 23(n) and 114(b)(4) of the Internal Revenue Code of 1939, printed in Appendix B, *infra*, page 28.

> "We think . . . the rights of the producers were completely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

The Third and Fourth Circuits disagree, however, as to whether a stripper has an economic interest if the payments he receives from the landowner do not vary with the market or if the landowner has the right to terminate the stripping contract.[8] The issue in this case is whether the Court of Appeals for the Third Circuit erred in holding that Parsons did not have the requisite interest because of these two factors.

It is clear from this Court's decisions in the oil and gas cases that the two factors relied upon by the Court of Appeals are irrelevant, and that Parsons had an economic interest in the coal it stripped and is therefore entitled to the depletion deductions which it claims.

---

8. The Fourth Circuit has held that these factors do not foreclose the existence of an economic interest. *Commissioner v. Gregory Run Coal Co.*, 212 F.2d 52 (4th Cir. 1954), *cert. denied*, 348 U. S. 828 (1954) (some of the contracts terminable on 30 days' notice; payment at a fixed price per ton); *Weirton Ice and Coal Supply Co. v. Commissioner*, 231 F.2d 531 (4th Cir. 1956) (contract terminable on 90 days' notice; payment at a fixed price per ton subject to adjustment for changes in labor costs); *Commissioner v. Hamill Coal Corp.*, 239 F.2d 347 (4th Cir. 1956) (contract terminable on 90 days' notice; payment at a fixed price per ton).

In *Usibelli v. Commissioner*, 229 F.2d 539 (9th Cir. 1955), the stripper operated under a terminable contract and was paid a fixed price per year for a fixed amount of coal to be mined. The Court held that the stripper had no economic interest. The *Usibelli* case is clearly distinguishable because the stripper was not dependent solely upon the production of coal for its income.

The Internal Revenue Service takes an arbitrary intermediate position and holds that the stripper has no economic interest if his contract is terminable upon less than one year's notice. G. C. M. 26290, 1950-1 C. B. 42.

B. *General Principles Relating to Depletion.*

The basic requirements of an economic interest were first announced by this Court in *Palmer v. Bender*, 287 U. S. 551 (1933), which held that the term "economic interest" does not mean title to, or ownership of, the mineral. On the contrary, it includes "every case in which the taxpayer has acquired, by investment, any interest in the [mineral] in place, and secures, by any form of legal relationship, income derived from the extraction of the [mineral], to which he must look for a return of his capital." 287 U. S. at 557.

"Investment" does not mean cost or cash outlay. Unlike depreciation, percentage depletion is not intended to return only cost, and the "allowance continues so long as minerals are extracted, and even though no money was actually invested in the deposit." The "investment" in the property is the contribution by the taxpayer of an asset essential to the mining enterprise. *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308, 312 (1956).

The interest acquired by the taxpayer need not comprise ownership of the coal. A contractual right to mine the coal is sufficient. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364 (1925). If the income derived from this interest is dependent solely upon production, the interest is an economic interest. It is the miner's "'possibility of profit' from the use of his rights over production, 'dependent solely upon the extraction and sale of the [mineral],' which marks an economic interest in the [mineral]." *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25, 34-35 (1946).[9]

These principles were recently reaffirmed by this Court in *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308 (1956). In that case an oil operator obtained a lease from

9. If the miner is not associated with production and does not contribute an asset essential to extraction of the mineral, he has only an "economic advantage", even though his payments may be dependent on production. *Helvering v. O'Donnell*, 303 U. S. 370 (1938); *Helvering v. Bankline Oil Co.*, 303 U. S. 362 (1938).

the State of California to drill for and produce oil from certain state lands lying off the coast of California. As required by state law, the operator obtained from adjacent upland owners the right to erect drilling equipment on their land, and by whipstock drilling from their land reached the oil deposit in the ocean. The operator agreed to pay the upland owners a stated percentage of its net profits for the use of their land. Unlike the usual case, the oil deposit did not lie beneath the land of the owners granting the right to drill. The question presented was whether the upland owners had an economic interest in the offshore oil and were therefore entitled to depletion on the net profits payments which they received. This Court held that they were entitled to depletion:

> "This contribution [of land] was an investment in the oil in place sufficient to establish their economic interest. Their income was dependent entirely on production, and the value of their interest decreased with each barrel of oil produced. No more is required by any of the earlier cases." 350 U. S. at 316.

C. *Parsons' Contribution to the Enterprise in Exchange for Which It Received a Right to Payments Based Upon Production Establishes Its Economic Interest.*

The basic requirements of an economic interest, first formulated in *Palmer v. Bender* and restated in the *Southwest* case, may be summarized as follows:

1) The taxpayer must acquire by investment an interest in the mineral in place;

2) The taxpayer's income must be dependent solely upon production of the mineral; and

3) The taxpayer's interest must decline in value as the mineral is exhausted.

1. The first of the Court's requirements is squarely met here. Parsons acquired, by its contract, a valuable interest in the coal in place—the right to mine it and be paid for it. This interest, like the contractual interest of the landowners in the *Southwest* case, was acquired by the investment of assets essential to the mining operation.

In the *Southwest* case the Court found that the land of the upland owners was essential to the drilling operation. "Without their participation there could have been no bid, no lease, no wells and no production." 350 U. S. at 315. The contribution of the use of their land to the venture in return for a contractual right to payments based upon production was "an investment in the oil in place sufficient to establish their economic interest." 350 U. S. at 316. No less essential to the production here was Parsons' investment in the venture of its entire organization, its know-how, and the stripping equipment. Without them no coal could be removed. If the contribution of land by an owner who has no other participation in the mining constitutes an economic interest, *a fortiori* the investment made by the operator himself must be sufficient.[10]

2. It is equally clear that the second requirement is met, for there can be no dispute that Parsons' income was dependent solely upon production. Under its salvage contract it could receive no payment whatever unless and until it discovered and produced marketable coal.

3. Finally, there can be no doubt that Parsons' interest in the coal progressively declined in value as the coal deposit was depleted. As each ton of coal was mined and

10. At the conclusion of its opinion in the *Southwest* case the Court cautioned that it did not have before it the case of a stranger "disassociated from the lease" who contributed a facility. 350 U. S. at 316-17. Nor does it here. Parsons, far from being a disassociated stranger, was itself the operator, the one to whom depletion deductions traditionally have been allowed. *E.g., Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312 (1934).

delivered to Rockhill, there remained that much less from which Parsons might thereafter realize income. Manifestly, therefore, the value of its contractual right to mine the coal decreased commensurately.

To paraphrase the words of this Court in the *Southwest* case:

> Parsons chose to contribute its organization and equipment to the coal stripping venture in return for income based on production. This contribution was an investment in the coal in place sufficient to establish its economic interest. Its income was dependent entirely on production, and the value of its interest decreased with each ton of coal produced. No more is required by any of this Court's decisions.

D. *Parsons Falls Squarely Within the Class of Taxpayers to Whom Congress Intended to Give the Depletion Allowance.*

The principles developed by this Court in allowing depletion to those who search for mineral deposits in return for income based upon production implement the intent of Congress in enacting the depletion provisions of the internal revenue laws. It is common knowledge that Congress intended by these provisions to stimulate the development of natural resources and compensate the operator for the risks inherent in his business. References to this purpose in Congressional debates and reports are numerous.[11] Illustrative is an exchange between the Honorable John Nance Garner, Congressman from Texas, and Mr. A. W. Gregg, Solicitor of Internal Revenue, during

11. *E.g., Hearings Before the Senate Finance Committee,* 65th Cong., 2d Sess. 44; S. Rep. No. 617, 65th Cong., 3d Sess. 6; *Discussion Before the House,* 65 Cong. Rec. 2799-2800; *Hearings Before the House Committee on Ways and Means,* 69th Cong., 1st Sess. 164; H. R. Rep. No. 1, 69th Cong., 1st Sess. 6; *Discussion Before the House,* 67 Cong. Rec. 774; S. Rep. No. 27, 69th Cong., 1st Sess. 3; *Discussion Before the Senate,* 78 Cong. Rec. 6182-83.

hearings before the House Ways and Means Committee leading to the Revenue Act of 1926, in which percentage depletion was first enacted as an administrative substitute for discovery value depletion. Mr. Garner propounded the following question to Mr. Gregg:

> "Was not one of the reasons given at the time, and which has been urged by a great many gentlemen throughout the country, that the discovery depletion was given to induce people to discover minerals and other things hidden in the earth, and that, it being a hazardous undertaking, where great losses were incurred by gamblers, if I may term them such, or the business men who indulged in it, that you gave them this deduction to encourage them to go into the earth and discover these minerals and oil? Was not that one of the reasons given?"

Mr. Gregg replied:

> "That was one of them; yes, sir. The other reason was that this was a very hazardous industry, which suffered great losses and made great gains, and that when they made these gains there should be some offsetting return because of the previous losses." *Hearings Before the House Committee on Ways and Means*, 69th Cong., 1st Sess. 164.

Similarly, in the Senate debate preceding enactment of the Revenue Act of 1934 the Honorable Thomas P. Gore, United States Senator from the State of Oklahoma, explained the purpose of discovery value depletion as follows:

> "Mr. President, the object of that legislation was to enable a man, particularly the wildcatter and the pioneer, when he was fortunate enough to discover an oil well, fortunate enough to discover an oil field, fortunate enough to serve society and himself, to have some concession based upon the nature of his industry

and the character of his risk; so it did provide that depletion might be based upon discovery value.

• • •

"I had a good deal to do with that legislation. I know the reasons which inspired it. I know that business cannot succeed unless some allowance of that sort i ade. If we destroy these venturesome spirits, then we turn industry over to the larger concerns which can take the risk when that risk becomes indispensable to their survival; but as long as they can they will remit that risk and shift it to the wildcatter and the pioneer." 78 Cong. Rec. 6182-83.

Parsons falls squarely within the class of taxpayers to whom Congress intended to give the depletion allowance, and to whom this Court has consistently allowed it in the past. Parsons committed its entire business operation to finding and extracting coal, bore the entire cost of the enterprise, and received no payment unless it found and extracted marketable coal. To it must belong the compensation provided by Congress for entrepreneurs who prospect for and produce minerals at the risk of losing their entire investment if they are unsuccessful. Parsons committed its know-how, payroll and equipment on the gamble that marketable coal might be discovered and exploited. It is the dedication of assets to an enterprise in search of natural resources, in precisely this fashion, which Congress sought to encourage.

II.

The Court of Appeals Erroneously Applied the Governing Principles of Law Announced by This Court.

The reasons given by the Court of Appeals for its conclusion that Parsons had no economic interest in the coal represent an erroneous application of the principles governing depletion announced by this Court.

The reasons assigned by the Court of Appeals may be summarized as follows:

(1) Parsons' contract was terminable by either party upon ten days' notice;

(2) Parsons was paid a stated price per ton of coal mined, irrespective of the market price; and

(3) Parsons' commitment of its capital was not "real and unequivocal" because its equipment was depreciable and suitable for another use.

A. *The Fact That Parsons' Contract Was Terminable by Rockhill Upon Ten Days' Notice Is of No Importance, and in Any Event Parsons Had the Right to Mine to Exhaustion All Coal Which It Uncovered.*

The Court of Appeals relied upon the fact that the contract between Parsons and Rockhill might have been terminated by either party on ten days' notice. This factor clearly has no relevance to a determination of the existence of an economic interest.

In the *Southwest* case the rights of the upland owners were terminable at the will of the operator, who could, without obligation to the landowners, modify or surrender its state lease.[12] Indeed, both the Tax Court and the Court of Appeals, in erroneously concluding that the upland owners had no economic interest, assigned as one of their reasons the fact that the upland owners' agreement might be terminated:

> "It would seem that the above-mentioned agreements could be terminated or modified at any time petitioner's agreement with the State of California was so terminated or modified. Under these circumstances it

12. The contract between Southwest (the operator) and the upland owners provided, *inter alia*, that "Southwest may, at any time, at its election, without any consent or participation by Second Parties [the landowners], modify said State Easement or surrender, and terminate the same in accordance with the provisions thereof." *Southwest Expl. Co. v. Commissioner*, 18 T. C. 961, 969 (1952).

would appear that the upland drill sites and the agreements granting them to petitioner could be abandoned and terminated by petitioner at any time the State of California might see fit to change its policy toward drilling in the submerged coastal lands." 220 F. 2d at 62, quoting 18 T. C. at 975.

In reversing the lower courts and holding that the upland owners possessed an economic interest, this Court simply said that "none of these possibilities occurred." 350 U. S. at 316.

Reliance on the terminability feature of Parsons' contract placed the Court of Appeals for the Third Circuit squarely in conflict with the decisions of the Court of Appeals for the Fourth Circuit holding that a termination provision in a stripper's contract does not deprive him of an economic interest. *Commissioner v. Hamill Coal Corp.*, 239 F. 2d 347 (4th Cir. 1956); *Weirton Ice and Coal Supply Co. v. Commissioner*, 231 F. 2d 531 (4th Cir. 1956); *Commissioner v. Gregory Run Coal Co.*, 212 F. 2d 52 (4th Cir. 1954), *cert. denied*, 348 U. S. 828 (1954). In the *Weirton* case the Fourth Circuit said:

"No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 in the enterprise. *It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all of the taxable years.* We think that Weirton's rights were dependent solely upon the extraction and delivery of the coal, and that the relationship of the parties to the ore in place gave it an economic interest in the mineral and entitled it to share with National [the owner] the depletion allowance provided by the statute." 231 F. 2d at 535-36. (Emphasis added.)

The decisions of the Court of Appeals for the Fourth Circuit are correct and in accord with reality. Since Parsons obtained an interest in the coal through its contract with Rockhill, and since its income was dependent entirely upon production, it had an economic interest in all the coal which it in fact mined. Of necessity, therefore, Rockhill's right to terminate the contract as to coal as yet undiscovered and unmined has no relevance.

Judge Kalodner, in his dissent below in the *Huss* case, put his finger on the irrelevance of terminability when he said (*infra*, Appendix A, page 25):

> "I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right." 255 F. 2d at 602.

An examination of the principle underlying depletion demonstrates inescapably that terminability cannot affect the existence of an economic interest. The realization of income from the extraction of natural resources necessarily results in the gradual exhaustion of the mineral deposit. Congress has therefore permitted a deduction for depletion so that part of the value of the mineral deposit may be recouped free of tax concurrently with the exhaustion of the deposit. Under this statutory scheme of depletion an economic interest, to be depletable, must be one which diminishes in value as the mineral is extracted.

It is at once apparent that the existence of a right of termination can have no effect upon the progressive diminution in value resulting from extraction. The value of *any* stripper's interest, whether terminable or not, declines as the coal is extracted. Any stripper will ultimately recover

only a certain amount of coal from a coal deposit. This amount cannot be determined precisely until the stripper removes his last ton of coal, either because the coal is exhausted or his contract is terminated. It is certain, however, that with the removal of each ton the stripper is one ton closer to the total which he will recover from the deposit. Hence the value of his interest decreases with each ton of coal produced.

The right of termination may have some relevance to the relative value of the stripper's economic interest, but has no bearing on the existence of that interest in the first instance. This Court is concerned only with the latter question.

Finally, consideration of the precise nature of the right of termination in the present case demonstrates that it cannot foreclose the existence of an economic interest. Subject to Rockhill's right of termination, Parsons had the exclusive right to mine areas allocated to it. It also had the right to mine to exhaustion all the coal which it uncovered, even though the time required to do so was more than ten days. Under such circumstances it is immaterial that its contractual right to uncover additional coal might be terminated. Parsons seeks no depletion allowance with respect to coal as yet uncovered, but only that which it prospected, uncovered and mined. As to such coal, it is conceded that its right to mine was unlimited and exclusive. In fact, as to coal which it uncovered, Parsons' contract was *not* terminable.

B. *The Fact That Parsons Received a Fixed Price Per Ton, Irrespective of the Market Price, Is Irrelevant.*

The Court of Appeals also relied upon the fact that Parsons received from Rockhill a stated price per ton, irrespective of the market price. The Court's reliance upon this factor was a surprising resurrection of an issue which the Department of Justice had apparently conceded in its

brief below [13] and which had apparently been laid to rest by its earlier decision in *Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535 (3d Cir. 1955), *cert. denied*, 352 U. S. 824 (1956).[14] Indeed, on at least two occasions this Court has granted depletion deductions to taxpayers whose interest in the mineral was realized through payments of stated amounts per unit of production. *Bankers Pocahontas Coal Co. v. Burnet*, 287 U. S. 308 (1932); *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364 (1925).

We believe that the view of the Court of Appeals is demonstrably erroneous. It is clear that Congress intended to compensate those who bear the risk of discovery of the mineral. Once the coal is above the ground, the risks are those of sale, a problem inherent in all businesses which does not warrant a special reward. Since the depletion allowance was not intended as a reward for assuming the risks of the market, it is obvious that a coal stripper need not assume the risk of the market in order to receive a depletion deduction. As Judge Kalodner succinctly stated in his dissent in the *Huss* case (*infra*, Appendix A, page 26):

> "Until now, every appellate decision in this type of case, including our own decision in Commissioner of Internal Revenue v. Mammoth Coal Co., supra, has

13. The Department stated its position as follows (Brief, page 18): "When an agreement defines a particular area in which a strip miner is to work and grants to him the exclusive right to mine that area until the mineral supply is exhausted, and provides that all coal mined is to be delivered to the land owner in return for a *stated amount per ton* delivered, it is our position that the miner's relationship with the mineral in place is such as to entitle him to an allowance for depletion." (Emphasis added.)

14. In the *Mammoth* case the Third Circuit had said, 229 F. 2d at 538:

> "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the [owner] should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

held that there is no requirement that the stripper must assume the risks of the ultimate market." 255 F. 2d at 603.

C. *The Fact That a Portion of Parsons' Investment Was Depreciable Property Suitable for Other Uses Does Not Defeat Its Economic Interest.*

The Court of Appeals relied upon a third factor, which, it said, "deserves separate mention." This factor may be summarized as follows:

> "[P]ercentage depletion . . . is premised on the conception that a tax free recovery of capital actually invested in a wasting mineral deposit is fair . . . . The commitment of capital as an investment . . . must be real and unequivocal."

Otherwise a miner is entitled only to depreciation, and not depletion.

> "[I]t is very doubtful whether investment in equipment of general utility in a contractor's business is the type of capital expenditure which can properly be found to constitute an investment in a particular mineral deposit. . . ." 255 F. 2d at 598-99.

There is a short answer to this. If the Court were correct, no stripper operating under a stripping contract would be entitled to depletion. Almost all stripping equipment can be put to another use and it is all depreciable. Logic compels the conclusion that the Court of Appeals has repudiated all the decided cases, its own included, allowing depletion to coal strippers.

The Court fell into three errors on this point. First, its reference to "capital actually invested" and "capital expenditure" indicates the Court believed that a cash outlay is required to support a depletion deduction. This, of

course, is erroneous. *Commissioner v. Southwest Expl. Co., supra,* 350 U. S. 308 (1956).

Second, the Court considered depreciation and depletion as mutually exclusive. This, too, is obviously erroneous. No one would dispute the proposition that if Rockhill had undertaken the operation as fee owner of the mineral it would have been entitled to deductions for *both* depletion and depreciation. It is likewise obvious that Parsons could not recover the cost of its equipment through depreciation deductions unless it discovered marketable coal and received gross income against which such deductions could be applied.

Third, and most important, the Court failed to comprehend the type of investment involved in the determination of an economic interest and the contribution which Parsons made to the venture. Parsons contributed far more than its tangible property. It staked its entire business operation, including its know-how, payroll and equipment, on the gamble that marketable coal could be discovered and exploited. This was its investment. The fact that it might, just as any oil operator or, indeed, any other businessman, be entitled to depreciation on tangible property is beside the point.

CONCLUSION.

The decision of the Court of Appeals should be reversed.

Respectfully submitted,

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APPENDIX A.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,315

No. 12,317

No. 12,319

GEORGE HUSS,
Appellant in No. 12,315

RUSSELL HUSS,
Appellant in No. 12,317

WESLEY HUSS,
Appellant in No. 12,319

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,
FIRST DISTRICT OF PENNSYLVANIA

SUR PETITION FOR REHEARING

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

Opinion of the Court

(Filed May 29, 1958)

* * *

KALODNER, *Circuit Judge,* dissenting.

I would grant the petition for rehearing. Further, on rehearing I would reverse the judgment of the district

court on the principal issue involved—the existence of an economic interest.

The Supreme Court has charted the course and the law in cases of this type. Only recently it stated, firmly and concisely, that a taxpayer is entitled to the depletion deduction "where he has: (1) 'acquired, by investment, any interest in the oil in place', and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital' ". Commissioner v. Southwest Exploration Co., 350 U.S. 308, 314 (1956).

"These two factors usually considered together", said the Supreme Court in the Southwest Exploration case, "constitute the requirement of 'an economic interest.' "

Nothing was said by the Supreme Court in that case on the score as to the impact of a right of termination of a contract creating an economic interest on the existence of that interest in the first place. Nor has the Supreme Court said so in any other case. We did not consider nor did we pass upon this question in Commissioner v. Mammoth Coal, 229 F.2d 255 (1955). Nor has any other appellate court done so except the Fourth Circuit. That Circuit, however, has explicitly ruled that a right of termination does not destroy an economic interest which existed prior to its exercise. It did so in two cases: Weirton Ice and Coal Supply Co. v. Commissioner, 231 F.2d 531, 533 (1956) and Commissioner v. Hamill Coal Corp., 239 F.2d 347 (1956).

In Weirton it was said (p. 535):

> "It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all the taxable years."

In Hamill, the contract (entered into in 1944) was to continue for one year and from year to year thereafter with

the right of either party to terminate it at any time upon 90 days' written notice. The contract was terminated in 1947 by mutual agreement "after Daniel [the stripper] had removed substantially all the coal with an overburden of less than 40 feet." (p. 349).

In Weirton the decision does not disclose when mining operation ceased or whether the stripper ever mined to exhaustion. In Hamill, however, the record discloses that subsequent to termination the owner of the mine actually mined some 90,000 tons of coal.

In the instant case it is undisputed that the stripper (taxpayers) mined to exhaustion and that the contracts were terminated by mutual agreement after such exhaustion so that the factual situation here is much stronger than in either Weirton or Hamill.

I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right.

It is not necessary, however, that I go as far along the course stated in the decision of the instant case. The record here discloses that the termination clause was included in the contract as a precaution on the part of the owner to protect itself from possible difficulties with an incompetent stripper.[1] It may be noted parenthetically that in the opinion sought to be reconsidered it was erroneously stated "We are not told the reason for including this cancellation clause."

---

1. Russell Huss testified (p. 60 N. T.) that the termination clause "was put in there in a form contract so as if they got hold of a contractor who was not reputable, who wouldn't live up to the contract, they could put him off the property without court action."

Assuredly, prior to the exercise of the termination clause, taxpayers here "had an economic interest in the oil [coal] in place through its [their] control over extraction." Burton-Sutton Oil Co., Inc. v. Commissioner, 328 U.S. 25, 34 (1946). That control, moreover, actually existed, as already said, until the property was mined to exhaustion. Further, as stated in Burton-Sutton Oil Co. "Depletion depends only upon production".

It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312.

There is no room for doubt that the taxpayers had the requisite control over production, for under the contracts, the Coal Company gave to taxpayers the exclusive right to mine all of the merchantable coal in place in the leased area. That such right might have been brought to an end does not affect the present fact that the economic interest existed.

There is also no room for doubt that the taxpayers depended solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including, but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operation profitable.

Until now, every appellate decision in this type of case, including our own decision in Commissioner v. Mammoth Coal Co., supra, has held that there is no requirement that the stripper must assume the risks of the ultimate market. To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, Commissioner v. Southwest Exploration Co., 350 U.S. at page 314, that the tax-

payer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do.

Although we said, in Commissioner v. Mammoth Coal Co., 229 F.2d at page 537, that "The facts in each case determine the result", I do not regard such declaration as an admission that the criteria to be applied are too vague to do so on other than the basis of "the reasonable man". To the facts must be applied statute and the specific rules pronounced by the Supreme Court in the interpretation of it. That is the teaching of Commissioner v. Southwest Exploration Co., supra.

I conclude, therefore, that the taxpayers during the taxable years involved had the requisite economic interest in the coal in place. This, to me, is the result required by the decisions of the Supreme Court, the Fourth Circuit, and this Court; and our present decision is inconsistent therewith.

Accordingly, I would grant rehearing and reverse the judgments of the district court.

APPENDIX B.

Internal Revenue Code of 1939.

§ 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

* * * * * *

(m) Depletion.

In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for a depreciation of improvements, according to the peculiar conditions in each case * * *.

(n) Basis for depreciation and depletion.

The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in Section 114.

§ 114. Basis for depreciation and depletion.

* * * * * *

(b) Basis for Depletion.

* * * * * *

(4) Percentage Depletion for Coal * * *—(A) In General.

The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. * * *

(B) Definition of gross income from property.

As used in this paragraph the term "gross income from the property" means the gross income from mining. The

term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment * * *.

Treasury Regulations 111.

§ 29.23(m)-1. Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements. Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. * * * An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, et al., PETITIONERS,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania, RESPONDENT.

No. 305

GEORGE HUSS, RUSSELL HUSS, et al., PETITIONERS,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania, RESPONDENT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, et al., PETITIONERS,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania, RESPONDENT.

No. 305

GEORGE HUSS, RUSSELL HUSS, et al., PETITIONERS,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania, RESPONDENT.

BRIEF AMICUS CURIAE

The Estate of John Schumacher, as amicus curiae, with the consent of petitioners and respondent (through the Solicitor General), hereby files this brief in support of the petitioners in these cases, which are before this Court on writs of certiorari to the United States Court of Appeals for the Third Circuit.

INTEREST OF AMICUS CURIAE

The issue here involved—whether a strip miner of coal has an economic interest and is therefore entitled to depletion on his income for mining—is the same issue involved in a series of cases now pending in the District Court of the United States for the Eastern District of Pennsylvania: *Estate of John Schumacher* v. *U. S.*, Docket Nos. 13,191 and 13,189; *Estate of Henry E. Schultz* v. *U.S.*, Docket Nos. 13,190 and 13,192; and *Robert Rowland* v. *U. S.*, Docket No. 14,625. In addition, the listed taxpayers (all of whom are represented by undersigned counsel) have the same issue in other tax years involved in other cases now pending, in which refund claims have been filed and rejected and suit about to be filed, probably in the United States Court of Claims.

QUESTION PRESENTED

Is a strip miner of coal entitled to a share of the percentage depletion allowance where he mines the coal pursuant to a contract giving him the exclusive right to extract coal from a particular property and where he is paid only upon the discovery and extraction of the coal? Or, does the stripper lose this right because his pay is not dependent upon the price at which someone else ultimately sells the coal and because the other party to the contract has the right to terminate the contract?

SUMMARY OF ARGUMENT

Although this Court has never passed on these questions as they apply to the coal industry, the principles this Court has enunciated in the oil cases in interpreting the same fundamental statutory provisions which control here, make clear the answers to these two questions.

The answer to the first question is yes: a strip miner who undertakes the job of looking for and extracting

whatever coal he finds and who is paid only for what he finds has the "economic interest" which this Court has said is the prerequisite to the right to share in depletion.

The answer to the second question is no: neither the method of the strip miner's payment, nor the right of the other party to the contract to cancel that economic interest, has anything to do with the determination of the existence of that economic interest in the first instance.

The Court below erred therefore in denying these strip miners the right to share in the depletion allowance. The Court below erred in not following this Court's decisions in such cases as *Palmer* v. *Bender*, 287 U.S. 551 (1933); *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599 (1946); *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25 (1946); and most recently, *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308 (1956); in not following the decisions of the Court of Appeals for the Fourth Circuit in such cases as *Commissioner* v. *Gregory Run Coal Co.*, 212 F.2d 52 (1954), *Commissioner* v. *Hamill Coal Corp.*, 239 F.2d 347 (1956), and *Weirton Ice & Coal Supply Co.* v. *Commissioner*, 231 F.2d 531 (1956); in not following its own earlier decision in *Commissioner* v. *Mammoth Coal Co.*, 229 F.2d 535 (1955).

ARGUMENT

Introduction

In the cases cited above, this Court outlined the basic concept of economic interest as it applied to depletion of oil interests. In the most recent of those cases, *Southwest Exploration Company*, this Court restated the two basic requirements for depletion which it had previously laid down in *Palmer* v. *Bender*, in this manner (350 U.S. at 314):

> " . . . a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship income derived from the extraction of the oil, to which he must look for a return of his capital."

The Court had also said substantially the same thing in *Burton-Sutton:* it is the operator's "possibility of profit from the use of his rights over production depending solely upon the extraction and sale of the oil which marks an economic interest in the oil" (328 U.S. at 34).

Since the statute providing for depletion is the same for both oil and coal, it should follow without question that these principles apply as well in the coal cases. Thus: the strip miners here acquired the right to strip mine coal from designated areas; they committed their assets and their entire business operation to finding and extracting the coal; they assumed all the risks inherent in finding and getting the coal out of the ground; and they were paid only if they found, extracted, and delivered the coal as per contract. They should therefore be held to have an economic interest and to be entitled to participate in depletion on their income from mining.

But the Court below held that although all these facts were true, the strip miners were still not entitled to a share of the depletion allowance because certain additional requirements were not satisfied; because the strip miners were paid without regard to the market price of the coal and because the party for whom the stripping was being done had the right to cancel the contract on short notice. As already stated, we urge that the Court below was wrong; that these secondary and extraneous circumstances have nothing to do with the initial question of the existence of an economic interest sufficient to support the depletion allowance.

Since this is this Court's first consideration of the application to the strip coal mining industry of the concept of economic interest, it might be helpful to review briefly the background of the overall question.

Legislative History

The first statutory provision took the form of cost depletion. Because natural resources inevitably are exhausted, the owner of those resources was allowed to recover his cost (or March 1, 1913 value, if higher than cost). This allowance involved but two elements: ownership, and proof of cost or March 1, 1913 value. See *United States* v. *Ludey*, 274 U. S. 295 (1927). This allowance was extended to a lessee by judicial decision in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364 (1925), dealing with the Revenue Act of 1916. The Revenue Act of 1918 (Section 214) specifically provided for an equitable division of the cost depletion allowance between lessor and lessee.

That same Act contained also the first step away from the conventional concept of depletion as a method of recovering cost. The new approach resulted from the legislative desire to encourage operations designed to get the coal above the ground. "To stimulate prospecting and exploration" of mineral deposits discovered after acquisition of the property, Sections 214(a)(10) and 234(a)(9) of the 1918 law provided for a limited tax on the sale of certain mineral producing properties and for depletion based on the value of those newly discovered resources. Senate Report No. 619, 65th Cong., 3d Sess., 1939-1, Part 2, Cum. Bull. pp. 121, 122.

But this new concept, unrelated to cost, involved burdensome administrative difficulties in proving the value of the newly discovered mineral deposits. Accordingly, retaining the fundamental idea that cost was not an integral part of any depletion allowance, Congress conceived the idea of percentage depletion. This first appeared in the Revenue Act of 1926 as to income from oil and gas wells and was extended to coal mining in 1932. As an inducement to the miner, percentage depletion could be taken so long as gross income was derived from the mining operation, despite the fact that the allowance

resulted in a deduction many times the amount originally invested or the mine's discovery value at the time the mining operation began. This fundamental aspect of percentage depletion was restated in 1951:

> "Under the present law, the amount of percentage depletion bears no relation to the capital cost of the property, but only to the income. . . . [S]ince the percentage depletion allowances are unrelated to the captital the tax-free recoveries through percentage depletion are often many times the original investment." 97 Cong. Rec. 12307.

Finally, Congress showed further need to induce mining by allowing percentage depletion without regard to whether the mine represented a new discovery. See 4 Merten's Law of Federal Income Taxation, § 24.31a (1954).

This brief analysis of legislative history discloses two things:

First, that percentage depletion has nothing whatsoever to do with recovery of cost or any other investment in the ordinary sense to acquire the particular natural resource involved. Thus when the cases speak about the taxpayer being permitted to "recover" his "investment" or "capital", it is obvious that they are referring not to a cost or capital outlay made by the taxpayer to acquire the right to receive the coal, but rather to what the taxpayer acquired by signing the binding contract which conferred upon him the exclusive right to extract the coal in place.*

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* This should suffice to dispose of a third ground used by the Court below for denying depletion to these strip miners. That Court said that the investment in machinery suitable for other than stripping purposes does not constitute the kind of investment needed to warrant the allowance of depletion. This point is without meaning here. The type of investment talked of with regard to depletion has nothing to do with machinery of any kind or the expenditure of money to buy a lease or fee or the outlay of any sum of money for any such purpose. As this Court said

Second, that the purpose behind percentage depletion is to encourage coal mining by providing a special tax benefit to those persons who actually extract the coal and take the risks inherent in mining. This is accomplished by allowing a deduction from the taxpayer's gross income derived from mining.

The Business Of Strip Coal Mining

A strip miner mines from the surface of the earth. He does not drive shafts into the earth to reach the coal as does a deep miner. In general, the mining is performed by stripping off the earth, known as overburden, which lies over the coal and removing the coal thus uncovered. The overburden is stripped by making "cuts" in the earth, the overburden from each cut being deposited in the adjacent cut from which the coal has been removed. The operation resembles plowing a field except that the "furrows" may be two hundred feet deep. Strip miners sometimes use scrapers for removing the overburden, but where the coal is farther from the surface the scrapers are replaced by draglines. These are massive machines which have tremendous booms from which are suspended by cables huge buckets capable of scooping up large quantities of earth at one time.* Cuts

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in the *Southwest Exploration Company case*, (350 U.S. at 312), depletion "continues so long as minerals are extracted, and even though no money was actually invested in the deposit".

Were this not so, no stripper under a salvage contract would ever have the kind of investment which would support the depletion allowance. If the law required a cash outlay for the purchase of "something depletable", no strip miner would ever be entitled to depletion. The opinion of the Court below on this point conflicts with every decision allowing depletion to a strip miner, as well as with this Court's decision in *Southwest Exploration Company*.

* Examples of the type of equipment used in strip mining, and their respective current costs, are: 32 yard dragline, $1,500,000; 25 yard dragline, $800,000; drill, used in attempting to locate coal, $120,000; 8 yard "straight front truck loader", $300,000; 32 ton delivery truck, $65,000.

from thirty to sixty feet wide and from five to two hundred feet deep are made with a dragline. Once the coal is uncovered it is cleaned, loosened with dynamite, removed by loading shovels, and transported by truck to the coal tipple.

Because of the nature of the operation there is a substantial risk of unprofitability in strip mining. Thus, different seams of coal separated from each other by a layer of earth, do not appear uniformly throughout a given area, but often have faults which cut them off. Moreover, the seams do not run at a uniform depth below the surface of the earth. At some points they come to the surface (known as cropping), thus ending the strip mining operation at such points. At other points the seams go into the earth at a steep pitch. In such cases the strip mining operation ceases to be profitable because a steep pitch greatly increases the amount of overburden to be removed within a short distance and makes it more difficult, if not impossible, to remove the coal with strip mining equipment.

Specific strip mining projects frequently call for the stripping of coal from large areas requiring several years. In many instances, the owner of the property supplies only the land, some maps and geological surveys; the stripper takes over from there. He supplies his own men, materials and equipment; he pays all expenses of the operation, including insurance and local taxes of all kinds; he builds all necessary roads and makes other improvements required to proceed with the mining. In a word: the stripper moves his own organization in and proceeds with the project. In some cases as where the property owner is also a coal company, it undertakes some of these responsibilities, such as having its superintendent inspect the stripper's equipment and stripping methods and approve the rate of operation, the particular direction on the tract in which the work is to proceed, and so on.

But basically, the work is done by the stripper at his risk.

Despite these risks inherent in discovering and extracting the coal and his substantial initial investment, the stripper mining under a salvage contract receives no payment whatever until the first truck load of marketable coal is delivered to the owner's tipple. His income is thus dependent entirely upon production of the mineral.

The Strip Miner's Right To A Share Of Depletion

In these circumstances there is no dispute over the basic fact that income earned in the mining process is subject to the depletion allowance. The question is: who is to share in the deduction? If coal is sold for, say, $3.50 per ton, does that full amount represent the income from mining of the land owner, or if the land owner has paid the stripper, say, $2.50 of that amount, does that $2.50 represent the stripper's income from mining and is it therefore subject to his own deduction for depletion, leaving to the land owner only the remaining $1.00 as his income from mining and confining his depletion deduction to that amount?

As matters developed, it soon became reasonably clear that the strip miner was entitled to share in the depletion deduction where he had the right to mine a designated area and was said only out of coal he mined. *Eastern Coal Corp.* v. *Yoke,* 67 F. Supp. 166 (N.D.W.Va. 1946). Under those circumstances, it was felt that the stripper had the required "economic interest in the mineral in place", this Court's concept of the sine qua non for depletion. *Palmer* v. *Bender, supra.*

As strip mining developed and as the general concept of depletion expanded, the stripper's efforts to secure some of the tax benefits attracted the attention of the Internal Revenue Service as an industry-wide matter.

This culminated in the issuance in March, 1950 of General Counsel's Memorandum 26,290 (1950-1 Int. Rev. Cum. Bull. 42). Although the GCM was a careful and thorough analysis of the entire situation, it started two lines of litigation, both of which have now joined in the two cases now under review.

The Need For The Stripper's Reliance On Sale

One of these lines stemmed from the phrase "extraction *and sale*" in that part of the basic rule that says the taxpayer must look to the extraction of the mineral in place as his sole source of return. The two words "and sale" seem to have crept in accidentally, by virtue of their original use to describe the fact that in most instances in the oil business, the mineral was in fact sold and the particular taxpayer involved was in fact paid out of the proceeds of sale.* But whatever the origin of those two words, the Tax Court allowed depletion to the strip miner who was paid a percentage of the coal company's sales price of the coal, but denied it to the stripper who had substantially all the same rights and privileges but who was paid a fixed price per ton without regard to the coal company's disposition of the coal. In effect the Tax Court's position was that the facts fell within one class [economic interest: *Ruston*, 19 TC 284 (1956)] or another [no economic interest: *Morrisdale Coal Co.*, 19 TC 208 (1952)] depending upon reliance on sale. In the first appellate court ruling on the question, the Court of Appeals for the Fourth Circuit in *Commissioner* v. *Gregory Run Coal Co.*, *supra*, saw no significance in any such distinction for depletion purposes. That Court reiterated that position in each of its subsequent decisions on

* The currently proposed Treasury regulations use the words "extraction *or* sale" (italics added). Sec. 1.611-1(b). These regulations are proposed under Sec. 611 of the 1954 Code which is, in this respect, substantially the same as Sec. 23(m) of the 1939 Code which governs these cases.

the point. *Hamill Coal Corp., Weirton Ice & Coal Supply Co.*, both *supra*, and *Stilwell* v. *U.S.*, 250 F. 2d 736 (4th Cir. 1957). The Court below agreed in its first decision on the question in *Mammoth Coal Co., supra*, where it said (229 F.2d at 538):*

> "The fact that, instead of retaining coal, the stripper received so much per ton for that coal which first had to be offered to and accepted by the . . . [coal company] should make no difference, for in any event the stripper had to look to the coal which it mined for return of its investment and profit."

That is precisely the contention we advance here: if strip miners A and B have identical rights, which would entitle them to depletion, the fact that A is paid a fixed price per ton for the identical mining operations can not operate to produce a tax result for him directly opposite to what is applicable to B just because the latter's pay fluctuates with the price of the coal on the coal market.

The method of payment to the strip miner has no bearing on the question of the existence in the first instance of an "economic interest", on the question of the federal income tax significance of the right to extract coal from particular property, when the extractor is paid, if, and only if, and when, the coal is extracted, thereby assuming all the risks inherent in finding and getting the coal out of the ground.

We urge that this fundamental proposition in no way depends upon whether the strip miner's economic interest in the coal continues *after* it has been discovered and

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* The only other appellate court decision on the question is *Usibelli* v. *Commissioner*, 229 F.2d 539 (9th Cir. 1955) which the Fourth Circuit in *Weirton, supra*, distinguished on the grounds that the strip miner's contract was a one-year contract for the U.S. Army which contracted to pay a certain sum for services rendered so that the taxpayer did not depend upon solely the severance of the coal for his income. 231 F.2d at 536.

mined and turned over to the coal company or anyone else for sale.

Against this background, it is difficult to understand the reasoning of the Court below in reviving a distinction which that Court itself had helped dispose of in *Mammoth*. Yet clearly the effect of the instant decisions below is to emasculate *Mammoth*. The dissenting judge on rehearing below put it this way (255 F.2d at 603):

> "There is also no room for doubt that the taxpayers depended solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including, but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operations profitable.
>
> Until now, every appellate decision in this type of case, including our own decision in *Commissioner* v. *Mammoth Coal Co., supra,* has held that there is no requirement that the stripper must assume the risks of the ultimate market. To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. at page 314, that the taxpayer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do."

The mystery of the Court's action below in ignoring its own earlier decision in *Mammoth*, as well as the opinions of this Court and of the Court of Appeals for the Fourth Circuit, is heightened by the fact that in its brief in these cases below (page 18), the government apparently conceded that the method of payment cannot operate to deny depletion where the other requisites are satisfied.

> "When an agreement defines a particular area in which a strip miner is to work and grants to him the exclusive right to mine that area until the mineral

supply is exhausted, and provides that all coal mined is to be delivered to the land owner *in return for a stated amount per ton delivered,* it is our position that the miner's relationship with the mineral in place is such as to entitle him to an allowance for depletion; the existence of his interest is coterminous with the existence of the mineral deposit and as each ton of coal is extracted that interest necessarily becomes less valuable." (empsasis added)

Even the government seems to agree then that the status of the coal market at a particular time, a question of salesmanship having nothing whatsoever to do with mining, should not affect—let alone determine—the existence or non-existence of an economic interest.

This same conclusion is dictated by the statutory definition of "gross income from mining". Section 114(b)(4)(B) of the Internal Revenue Code (1939), provides that mining is considered to include, "not merely the extraction of the ores or minerals from the ground" but also the subsequent ordinary treatment processes necessary to obtain the commercially marketable product as well as certain transportation costs. No reference whatsoever, however, is made to the sale of the mineral. The inclusion of the subsequent processes, of course, does not mean that a taxpayer who assumes the risk inherent in the basic job—i.e., extraction of the ore—is denied percentage depletion because he is not *also* involved in the fringe and later processes which are also given the benefit of percentage depletion. Rather these subsequent processes are specifically included so as to make it clear that the gross income upon which the deduction is based is not limited solely to that derived from the extraction.

The vice in the position of the Court below on this point is that not only does it tack on the selling process, found nowhere in the Code, but it makes that process a *sine qua non* of enjoyment of percentage depletion for those taxpayers who perform extraction *and* some or all of the other activities specifically set forth in the statute.

As the Court of Appeals for the Fourth Circuit said in the first appellate court decision on the issue, *Gregory Run Coal Co.*, (212 F.2d at 61):

> "We think, however, that in the pending case the rights of the producers were completely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

Under the principles established by this Court in the oil and gas cases, against the background of the governing legislative history, and as those principles have been applied in other cases, it is clear that the strip miners here involved have an economic interest and are entitled to a share of the depletion allowance.

The Significance Of Terminability Of The Stripping Contract

The second element of GCM 26,290 which is involved in these cases concerns its provisions dealing with the right of the party for whom the stripping is being done to terminate the contract.

Here again a condition has been engrafted—without foundation—on the basic principles announced by this Court as to the economic interest concept required to support a share of the depletion allowance. This Court has in effect already indicated its opinion that this factor is without significance. In the *Southwest* case, the contract between Southwest (the operator) and the upland owners provided that the operator had the election to amend or surrender its drilling easement from the state, thereby terminating the upland owner's contract and his basis for sharing in depletion. Despite the fact that the operator in opposing the upland owner's attempt to share in the depletion made the specific argument on brief (p. 1) that this right of termination destroyed the upland

owner's economic interest, this Court did not even consider the point in its opinion. But with regard to such similar contentions that the operator might have drilled without using the upland owners' land or that the controlling state law might have been amended so as to eliminate the need for using that land, this Court said simply. "But none of these possibilities occurred." (350 U.S. at 316)

The Court of Appeals for the Fourth Circuit made the even more categorical in three decisions dealing with the precise point. In the *Weirton* case (231 F. 2d at 535), that Court stated:

> "It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved Weirton actually mined the coal during all of the taxable years."

The Fourth Circuit reached the same conclusion in the *Gregory Run* and *Hamill* cases despite the right of the coal company in those cases to terminate on 30 and 90 days' notice respectively.*

The dissenting judge on rehearing below took the same position (255 F.2d at 602):

> "I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situa-

* Cf. *Stilwell* v. *U.S.* 250 F.2d 736 (4th Cir. 1957) where, after citing with approval its three earlier decisions listed above, the Fourth Circuit held that there was no right of termination, but then went on, unnecessarily, to use language—in one sentence—which could indicate some confusion as to the significance of terminability. The Court below made no point of this and in fact included *Stilwell* in the same category with the other three Fourth Circuit decisions which the Court below described as "recent borderline cases".

tion as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right."

We urge that these cases and the dissent below are sound. The contract power to terminate the stripper's economic interest has nothing to do with the existence of that right in the first instance. The power of termination is relevant only if it is actually exercised and then only because it may affect gross income from mining which thus in turn affects the amount of depletion allowance. But these quantitative considerations are of no greater moment here, in relation to the basic question of the *right* to depletion, than are such things as the cost and life of an asset in relation to the existence of the *right* to (as opposed to the amount of) depreciation. Obviously, the lower the cost and the longer the life of an asset, the smaller the amount of the annual deduction for depreciation. But the *right* to any deduction at all exists even if the asset cost only $10.00 and has a life of ten years. So here: the cancellation of a contract or the reduction of the tonnage to be mined may reduce the amount of the income from mining and therefore necessarily the amount of the deduction for depletion. But these *quantitative* considerations have no other relevance. They cannot affect the basic, initial question of whether there is an economic interest to start with.

The irrefutable soundness of this conclusion is demonstrated by the difficulties created by any effort to determine the point at which these limitations of quantity are effective to prevent the existence of an economic interest. In G. C. M. 26290, *supra*, the Commissioner decided that if a stripping contract cannot be terminated within a period of less than one year, then ordinarily the stripper has an economic interest because he has enough time to mine "*a substantial* portion of the mineral deposit" (italics added). What is "substantial"? Suppose the prop-

erty involved is sufficiently large as to require fifteen years to complete its stripping and that unusual amounts of overburden make it clear that disproportionately small amounts of coal will be mined in the first several years? Is less than 1/15 of the coal involved "substantial"? Furthermore and of more fundamental importance, is it not entirely consistent with the whole history and purpose of percentage depletion—and in fact do not that history and purpose require the conclusion—that the stripper acquires an economic interest upon the signing of such a contract pursuant to which, at his sole risk, he contributes his business organization to the enterprise; that the only significance of cancellation and the like is in relation to the monetary tax result which flows from the existence of that interest in the form of the deduction for depletion.

Continuing with the GCM, it provides that where the stripping contract is terminated on less than one year's notice, then all the facts must be considered in determining whether that power to terminate prevents the creation of the economic interest in the first instance. Among the facts listed are the size of the deposit and the estimated time required for its extraction. Thus, if cancellation requires notice of one year and a day, the presumption is that the stripper has an economic interest; but if notice need be for only 364 days, then it depends on whether the stripper has enough time to qualify his rights as an economic interest. Yet in each case both strippers perform exactly the same function in the same manner under the identical contract giving them identical rights and obligations, the only difference being two days in the notice period. There is no sound basis for this distinction insofar as the fundamental issue of the existence of an economic interest is concerned. We submit that that issue is not affected by the limits on the amount of coal to be mined or by any other consideration going to the value of the strip-miner's interest.

CONCLUSION

A strip miner of coal who contributes his business organization to a strip mining enterprise under a contract pursuant to which he is paid only out of the coal he discovers, extracts and delivers, has no less of an economic interest than the oil driller in *Palmer* v. *Bender* or the upland owners in *Southwest Exploration Company*. Such a strip miner has acquired an interest in the coal in place and he derives income from the extraction of that coal to which he must look for his compensation. Such a strip miner is entitled to a share of the depletion allowance, without regard to the method by which he is paid or the fact that his stripping contract can be terminated. Those considerations are relevant solely as to the secondary question of how much income from mining the strip miner might realize; those considerations have nothing to do with the initial question of whether the strip miner has an economic interest in the coal in place. This result is dictated by the legislative history and the prior decisions of this Court. The Court below erred in finding to the contrary. Its decisions should be reversed.

Respectfully submitted,

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v.

FRANCIS B. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF PARAGON JEWEL COAL COMPANY, INC., AS AMICUS CURIAE.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., *Petitioners,*

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania

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On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF PARAGON JEWEL COAL COMPANY, INC., AS AMICUS CURIAE

Pursuant to Rule 42(2) and the written consent of the parties hereto, Paragon Jewel Coal Company, Inc., files this brief as *amicus curiae.*

INTEREST OF AMICUS CURIAE

The present case involves the question whether a contractor engaged in mining coal is entitled to a percentage depletion allowance, and, as the Solicitor General pointed out when the petition for certiorari was pending here (Resp. Memo. 3-4), "to the extent that the strip miner is allowed a depletion deduction, there

must be a corresponding disallowance of the deduction to the owner of the property.'"[1]

Paragon Jewel Coal Company, Inc., a Virginia corporation, is the lessee of coal lands in the Commonwealth of Virginia. It does not mine coal itself, but makes contracts with other corporations and individuals for the actual mining. The extent and details of its operations are set forth below, pp. 4-9.

In *Stilwell* v. *United States*, 250 F. 2d 736 (C. A. 4), certain parties who had contracts with *amicus curiae* (hereinafter called simply Paragon Jewel) to mine coal were granted the right to a depletion allowance, with the result that the depletion allowance available to Paragon Jewel stands to be correspondingly diminished. The result in that case operated to the disadvantage of Paragon Jewel, which, in substance and effect, lost the case; but since it was not a party thereto, it was not able to seek review, and it now faces uncertainty as to its tax liability for that and future years.

The Third Circuit in the case at bar specifically refused to follow the *Stilwell* decision. R. 37-38; see also the companion case, *Huss* v. *Smith*, No. 305, at R. 82 (sur petition for rehearing).

Paragon Jewel has accordingly a substantial interest in establishing that the Third Circuit has correctly

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[1] Respondent's Memorandum, just cited, applied also to No. 305, *Huss* v. *Smith*, now pending on writ of certiorari and consolidated for hearing with the present case. See J. Sup. Ct., Oct. T. 1958, p. 13. The Solicitor General's consent to the filing of the present brief extended also to No. 305. Consent to filing was similarly requested of counsel of record for the petitioners in No. 305, who however did not respond to communications sent him, and in that sense did not consent.

construed the statute in the present cases, and that the Fourth Circuit fell into error in the *Stilwell* case in allowing to the contractor of Paragon Jewel any share of the depletion allowance.

Contrariwise, it is apparent from the Solicitor General's Memorandum heretofore filed herein that the Government is simply a stakeholder. He said (Resp. Memo. 3-4):

> "2. It is important in the administration of the revenue laws that the issue presented be finally resolved. The depletion allowance is one that must be 'equitably apportioned between the lessor and lessee' of mineral property. Section 23(m) of the Internal Revenue Code of 1939. Percentage depletion is allowed, under Section 114(b) of the Code, on the 'gross income from the property' and, to the extent that the strip miner is allowed a depletion deduction, there must be a corresponding disallowance of the deduction to the owner of the property. See *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 309. Thus, uncertainty as to whether a strip mining contractor is entitled to the deduction makes administration of the law in this respect difficult."

The same view is reflected in a recent paper by an official closely concerned with tax litigation at lower levels: "To the government generally it is a matter of comparative indifference which side bears the burden of the tax, just so the matter is settled and the government is not whipsawed." Treusch, *Litigation Policy of the Chief Counsel's Office in Civil Tax Cases*, 36 Taxes 958, 969. The quoted comment was made with specific reference to the coal depletion problem, including the present case, and to the inconsistent Government positions reflected in *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 309, note 1.

Such inconsistency is inevitable, inasmuch as the Government is bound to resist the attempt of each taxpayer concerned to establish his right either to any depletion allowance whatever or else to a larger portion of such allowance. This condition is amply demonstrated in the cases discussed below, pp. 27-33. But where, as in all of the cases—this one as well as the others—there is a percentage depletion allowance to be divided between different taxpayers, the Government's interest in the suit of either one is only nominal, and the true adverse party remains unrepresented in a litigation which vitally affects its own tax liability.

The quoted excerpts indicate that the Government is concerned only that there be a consistent rule to facilitate the administration of its tax laws. Paragon Jewel, on the other hand, is deeply concerned with the substance of the rule to be formulated. Consequently it files this brief *amicus curiae*, not simply on the all too common basis of "me too" or of "anything-you-say-we-can-say-better," but in order that the views of the interest genuinely adverse to that of the present petitioners may be before the Court.

As will be seen, Paragon Jewel supports the decision below on the view that the result contended for by petitioners here, which was reached by the Fourth Circuit in *Stilwell* to the detriment of *amicus curiae*, involves an egregious misreading of the statute.

OPERATIONS AND BUSINESS OF AMICUS CURIAE

Amicus curiae, Paragon Jewel Coal Company, Inc., is a small Virginia corporation, with an authorized capital stock of $100,000, of which only $37,500 has been issued. Its principal place of business is at Bluefield, West Virginia, but its properties are in

Virginia, where it is lessee of some 4932 acres of bituminous coal land under eight separate leases.

Its average annual coal production for the years 1953 to 1957 inclusive was 417,158 tons, or about one tenth of one percent of the average national production.[2]

In areas where bituminous coal is found in thick seams, of from 50 inches to 10 or 12 feet, underground mining has become an increasingly mechanized operation, so that in 1957 some 80% of all underground coal was cut by machines. Where the thick seams are reasonably close to the surface, mining is done by stripping; i.e., large shovels and draglines strip off the earth and expose and then mine the coal. Today some 25% of all bituminous coal is mined by stripping. Petitioners in this and the companion cases are strippers.[3]

The seams in the coal properties leased by Paragon Jewel are only about 27 to 28 inches thick. Such shallow seams are known as "low coal"; they are not capable of being mined by mechanization, as no automatic machinery can cut or load low coal. The coal is therefore extracted by the process of "drift mining," which consists of "facing" the side of the coal-bearing hill—

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[2] The total national bituminous coal production for the same period averaged 460,900,600 tons per year. See National Coal Association, *Bituminous Coal Facts 1958*, p. 55, based on U. S. Bureau of Mines figures.

[3] Present day bituminous coal production trends and figures are discussed in *Minerals Yearbook—Fuels* (H. R. Doc. 23, 84th Cong., 1st sess.), Vol. II, pp. 30-93; Sherman & MacMurphy, *Facts About Coal* (U. S. Dept. Int., Bu. Mines, 1955 ed.) 11-21; *Mineral Facts and Problems* (U. S. Bu. Mines Bull. 556, 1956) 121-124; *Bituminous Coal Facts 1958*, *supra* note 2, 13-18; *Bituminous Coal and Lignite in 1957* (Bu. Mines Mineral Market Summary No. 2830, Sept. 26, 1958) 28-68.

i.e., removing the earth to expose the coal seam—and then mining directly into the hill, cutting away the coal as it is reached by a horizontal opening. (In mining terminology, a "drift" is a horizontal tunnel made into the side of a hill, as distinguished from a "shaft," which is a vertical opening straight down into the earth.)

Drift mining is essentially a marginal operation, and therefore Paragon Jewel, like most other lessees similarly situated, employs independent contractors to do the actual mining. This relieves Paragon Jewel of the expenses of providing equipment and maintaining an elaborate organization. In many instances, shallow thin-seamed drift mines are worked by miners who suffered technological unemployment in consequence of the widespread mechanization of thick-seamed mines.

As has been indicated, Paragon Jewel is not the owner of the land in fee, but simply a lessee of the coal. The operative portions of a typical Paragon Jewel lease now in force are set forth in Appendix A, *infra,* pp. 1a-8a. Under that lease, Paragon Jewel pays a minimum mining royalty, payable whether or not any mining is done; and it pays all real estate taxes imposed by Virginia law.

Prior to making contracts for mining the coal, Paragon Jewel built roads, power lines, and railroad sidings, and, most important of all, it constructed a tipple. Its capital outlay for these items came to about $725,000. All coal mined by its contractors is brought to the tipple, where it is cleaned, washed, and graded as to size. This operation is an indispensable prerequisite to marketing the product, inasmuch as uncleaned and ungraded mine-run coal, in

the condition in which it is delivered to the tipple, is not commercially saleable.[4]

Paragon Jewel's relations with its contractors are now formalized by a written contract on a standard form; a copy is provided in Appendix B, *infra* pp. 9a-13a.

Under the terms of that contract, Paragon Jewel faces up the seam for entry by the contractor, and Paragon Jewel directs the contractor where it is to mine. The contractor is compensated by being paid a fixed price for every ton of coal delivered to Paragon Jewel at its tipple. This price is set forth in the contract, and is not subject to change retroactively. The contract provides for prospective changes in compensation on "at least three days' notice," so that such changes will apply only to unmined coal. Thus it is Paragon Jewel and not the contractor who bears the risk of the market. Finally, the contract is terminable at the will of either party on written notice.

It is proper to point out that, while all but two of Paragon Jewel's 32 contractors have now signed this written agreement, which simply formalized prior oral arrangements, the occasion for the written contract was the disregard by the Fourth Circuit in *Stilwell* v. *United States*, 250 F. 2d 736, of the specific findings of fact made below, *Stilwell* v. *United States*, 152 F. Supp. 111 (W. D. Va.). This appears from the following extracts:

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[4] See, as to the importance of cleaning coal, the following references in the works already cited: *Minerals Yearbook—Fuels*, 93-113; Sherman & MacMurphy, *Facts about Coal*, 21-22; *Mineral Facts and Problems*, 124-125; *Bituminous Coal Facts 1958*, 17-18; *Bituminous Coal and Lignite in 1957*, 69-80.

(A) *Finding 14, 152 F. Supp. at 113*

"14. The contract entered into between plaintiffs and Paragon was terminable at the will of either party."

(A) *C.A. 4 opinion, 250 F. 2d at 739*

"The contract was not terminable by Paragon as long as taxpayers' operations were satisfactory and the coal could be profitably marketed. • • • This is not a case where the contract is clearly terminable at the will of either party • • •."

(B) *Finding 16, 152 F. Supp. at 113*

"16. Plaintiffs completed their obligation under the contract by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay for such services at the amount per ton previously agreed upon by the contracting parties. Plaintiffs were not concerned with the sale price Paragon received for the coal."

(B) *C.A. 4 Opinion, 250 F. 2d at 739*

"This is not a case • • • where the contractor's income is dependent upon the personal covenant of those with whom he has contracted without regard to the price at which the coal is sold."

It is also proper to point out that drift mining differs in some respects from the strip mining that is directly involved in the present case. The strip miner normally builds his own roads, he must find the coal in a general area assigned to him, he must furnish his own power, and he has a larger investment, because his machinery is larger and hence more expensive. The drift miners under contract with Paragon Jewel do not build any roads, mine only as and where directed by Paragon Jewel, do not normally supply power lines, and have a very much smaller capital investment in machinery.

Under our views of the governing law, views fully set forth in the course of the argument, these

differences do not add up to a legal distinction and indeed are quite irrelevant.

SUMMARY OF ARGUMENT

I. "In essence, the deduction for depletion does not differ from the deduction for depreciation" (*United States* v. *Ludey,* 274 U. S. 295, 303, *per* Brandeis, J.), the purpose of both being to compensate the owner of a capital asset that is used up in the course of producing income.

In the case of leases, the depletion allowance is required to be equitably apportioned between lessor and lessee (§ 23(m), I.R.C. 1939, and cognate provisions from 1918 through 1954), and where a rigid application of conventional common law estates might work injustice, depletion is allowed to any taxpayer who acquired, through a capital investment on his part, an economic interest in the mineral in place. *Palmer* v. *Bender,* 287 U. S. 551. But the depletion allowance is not available to one who has no capital investment in the mineral in place, but simply has, through contract, an economic advantage from production of that mineral. *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362, *per* Hughes, C. J. That differentation, between economic interest acquired by capital investment and mere economic advantage obtained by contract, was written literally into the Treasury Regulations in 1939, and has been there ever since; the version applicable in the present case is Treas. Reg. 111, § 29.23(m)-1.

No authoritative materials support the contention that the purpose of the depletion allowance (as distinguished from its amount in particular instances) was to encourage development of mineral resources by

compensating prospectors for their risk. In any event, contractors engaged in stripping or drift-mining of coal assume no appreciable risk; they work known coal fields. And the present petitioners had other activities to which their machinery was adapted, and indeed insisted that their coal mining contract be terminable in order that they might be free to revert to their other pursuits.

II. Later oil and gas cases in this Court have blurred the distinction originally laid down, see *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 313-314, and thereafter the lower courts, particularly the Fourth Circuit, have concentrated on the words "economic interest" to the exclusion of the necessary qualification "which represented their capital investment." The Fourth Circuit has accordingly in a series of cases granted a share of the depletion allowance to taxpayers who simply contracted with the owner of the fee or with the lessee of the coal lands, in situations where the taxpayer had no capital investment whatever in the minerals in place. This result, which petitioners urge in the present case, distorts the statute and perverts the purpose of the depletion allowance.

III. A. Petitioners are not entitled to a depletion allowance because they have neither made nor acquired any capital investment in the coal in place. Their capital investment in machinery is recoverable through the depreciation allowance, so that to give them in addition a share in the depletion allowance would be a purely gratuitous benefit neither intended nor warranted by the statute. Ownership of the mineral deposit is essential to a right to deduct for depletion. *Thomas* v. *Perkins*, 301 U. S. 655, 661. Treas. Reg.

111, § 29.23(m)-1(i), applicable here, speaks of "the interest owned by the taxpayer in any mining property." Petitioners cannot point to any interest that they owned in the tracts they were mining.

B. Their lack of ownership of the coal in place is emphasized by the fact that they received a fixed price for mining the coal, which was not subject to market fluctuations. This circumstance is, and has been held to be, virtually conclusive against a contractor's claim to depletion. But where the contractor has no capital investment in the coal in place, he should not be entitled to a deduction for percentage depletion regardless of how his compensation is fixed.

C. Petitioners are not entitled to share in the depletion allowance because their contracts were terminable at the will of the owner of the coal lands. This circumstance, also, has been held to constitute a well-nigh conclusive bar to allowing the contractor any depletion deduction. The true rationale, it is submitted, is that a contract terminable without compensation at another's whim utterly negatives the notion that the contractor invested capital on those terms.

D. Petitioners' contract here was non-exclusive, but even under an exclusive contract they would not be entitled to depletion. Two contractors cannot mine the same area simultaneously, and if one mines after the other, the same considerations apply as those already mentioned under terminability.

E. The fact that there may be a right under the contract to mine a particular tract to exhaustion is immaterial. Most contracts for the completion of a particular job necessarily contemplate that the work

will eventually come to an end, but that fact does not give the contractor a depletion allowance for the progressive diminution of the value of his contract.

F. If the rule that weight is to be given long-continued administrative interpretations has any force at all, then the Treasury's consistent stand against the depletion deduction to contractors in petitioners' position bars them here. Treas. Reg. 103, § 19.23(m)-1; Treas. Reg. 111, § 29.23(m)-1; Treas. Reg. 118, § 39.23(m)-1(a) and (b); GCM 26290, Cum. Bull. 1950-1, p. 42.

IV. The legislation which since 1951 has permitted the lessor of coal lands to capitalize his royalty income as a substitute for a share of the percentage depletion allowance constitutes an additional reason why a mere contractor is not entitled to any portion of such allowance.

In 1951, Congress amended § 117(k)(2) of the Internal Revenue Code of 1939, and thereby gave the lessor of coal lands — but not of oil or gas lands — capital gains treatment for his royalties in lieu of the equitable apportionment of the depletion allowance theretofore his under § 23(m). Since 1951, therefore, the lessee of coal lands is entitled to an indivisible depletion allowance. The contractor is plainly not a lessor, nor can he be considered a lessee. And other portions of the 1951 amendments show that Congress did not intend to confer on the taxpayer who only held a contract to mine the coal any right to share in the allowance for percentage depletion.

The foregoing conclusions, drawn from the 1951 amendments, are confirmed even more strongly by the clarifying revisions made in the 1954 Code.

The 1951 legislation appears to have been completely overlooked in all cases to which it would be applicable by its terms. The committee reports do not mention the present problem, which up to then had never been decided in favor of the contractor in reported litigation. But the 1951 amendment throws a revealing cross light on the statute, emphasizing the unsoundness of the lower courts' concentration on "economic interest" in disregard of the necessary qualification that such interest must represent an investment in the coal in place. Accordingly, the 1951 amendments (and, *a fortiori*, the 1954 revision) underscores the basis of the original decisions here on the rationale of the depletion allowance (*United States* v. *Ludey*, 274 U. S. 295; *Palmer* v. *Bender*, 287 U. S. 551; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362), decisions whose underlying principle is conclusive against the present petitioners and against any other taxpayers who, similarly, simply contract to mine coal for others.

ARGUMENT

Paragon Jewel's position is that the decision below in the present case is clearly right, and that the contrary result reached by the Fourth Circuit, which allowed percentage depletion to one of Paragon Jewel's independent contractors who had no capital investment in the coal deposits being mined, is clearly wrong. *Stilwell* v. *United States*, 250 F. 2d 736; see also other Fourth Circuit cases discussed at length below, pp. 27-28, 30-33.

The Fourth Circuit rulings are erroneous, basically because they ignore the purpose of the depletion deduction, and because they have accordingly con-

centrated on the concept of "economic interest"—which was a wholly non-statutory expression prior to 1951—applying it as though it were a slogan while ignoring its essential qualification, namely, that it must be an economic interest in the wasting mineral asset which represents a capital investment.

The resultant misapplication of the statute operates to the disadvantage of Paragon Jewel, a coal lessee with a substantial investment in the coal in place, and of others with either leasehold or fee interests in coal lands, who similarly make contracts with outsiders for the extraction of their coal.

In the present confused state of the case law, Paragon Jewel believes that a reexamination of the fundamental principles underlying the percentage depletion provisions of the Internal Revenue Code will prove helpful to the Court.[1]

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[1] Neither this case nor its companion involve, nor do we discuss, the many related depletion problems that are met with in the books. E.g., are coal lands containing materials already extracted from a coal mine subject to a further depletion allowance? Compare *Kohinoor Coal Co.* v. *Commissioner of Internal Revenue*, 171 F. 2d 880 (C.A. 3), certiorari denied, 337 U. S. 924, with *Turkey Run Fuels* v. *United States*, 243 F. 2d 147 (C.A. 3). E.g., is the dollar base for computing the percentage depletion the cost of the mineral deposit in its natural state (e.g., clay), or the cost of the ultimate product after manufacturing (e.g., bricks)? See *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5), certiorari denied, 355 U. S. 824; see also *Dragon Cement Company* v. *United States*, 244 F. 2d 513, certiorari denied, 355 U. S. 833. E.g., what are "ordinary 'treatment processes'" for purposes of computing the amount of the percentage depletion? See *Commissioner of Int. Rev.* v. *American Gilsonite Co.*, 259 F. 2d 654 (C.A. 10).

I. THE DEPLETION ALLOWANCE IS A FORM OF DEPRECIATION ALLOWANCE, AND IS AVAILABLE ONLY TO THOSE WHO HAVE AN ECONOMIC INTEREST, ACQUIRED BY INVESTMENT, IN THE WASTING CAPITAL ASSET OF MINERALS IN PLACE.

Some thirty years ago, Mr. Justice Brandeis with his customary lucidity explained the rationale of the depletion allowance granted by the internal revenue laws to owners of mineral deposits. *United States* v. *Ludey*, 274 U. S. 295. He said (274 U. S. at 302):

> "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must be approximated. And because the quantity originally in the reserve is not actually known, the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion."

And he added (274 U. S. at 303), "In essence, the deduction for depletion does not differ from the deduction for depreciation."

In this connection, it is significant that, in the first income tax act following adoption of the Sixteenth Amendment, Congress lumped depreciation and depletion under a single heading.[2]

The last sentence quoted from the *Ludey* opinion deserves special emphasis as applied to the case of strip or drift mining: The owner of the coal deposits, who has invested in the coal, receives an allowance for depletion of that capital asset; the contractor, who has invested in mining machinery, receives an allowance for depreciation of his machinery—which is his capital asset. The contractor in such a situation should not receive a depletion allowance as well. Yet that is what petitioners are seeking here.

Beginning with the Revenue Act of 1918 and continuously thereafter, the depletion allowance provisions of the Internal Revenue Acts have provided, with hardly any change in phraseology, that "In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee."[3]

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[2] Sec. II B [Deductions] of the Act of Oct. 3, 1913, c. 16, 38 Stat. 114, 167: "* * * sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year in which the computation is made * * *."

[3] Sec. 214(a)(10) of the Revenue Act of 1918; § 214(a)(10), Revenue Act of 1921; § 214(a)(9), Revenue Act of 1924; § 214(a)(9), Revenue Act of 1926.

In 1928, the sentence was changed to read, "In the case of leases the deduction shall be equitably apportioned between the lessor and lessee." § 23(1), Revenue Act of 1928.

With the single change of "deductions" for "deduction", the revised phraseology was repeated in § 23(1), Revenue Act of

In the case of oil wells, it soon became apparent that a rigid application of conventional common law estates might work an injustice, and in *Palmer* v. *Bender*, 287 U. S. 551, it was held that where the owner of an oil or gas lease transferred his lease to another in consideration of a bonus and royalties, the bonus so received was a return *pro tanto* of the transferor's capital investment in the oil, entitling such transferror to a depletion allowance.

The Court, *per* Stone, J., said (287 U. S. at 558):

> "In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute. *Lynch* v. *Alworth-Stephens Co.*, [267 U. S. 364] *supra*. When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor. *Burnet* v. *Harmel* [287 U. S. 103], *supra; Bankers Pocahontas Coal Co.* v. *Burnet* [287 U. S. 308], *supra*. Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partner-

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1932; § 23(m) of the Revenue Acts of 1934, 1936, and 1938; and in § 23(m) of the Internal Revenue Code of 1939.

In 1954, the substance of the foregoing was again repeated in § 611(b)(1), I.R.C. 1954, in these terms: "(1) **Leases.**—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and the lessee."

> ships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case."

It is to be noted that the foregoing rationale depends on "an economic interest in the oil, in place," representing a "capital investment." We stress the qualifications, because, as will be seen, petitioners here and the Fourth Circuit in the cases discussed below (pp. 27-28, 30-33), have ignored it and have concentrated on the words "economic interest" to the exclusion of all else.

A few years later, the Court reviewed the cases, emphasizing that the depletion allowance was not available to one who had no capital investment in the mineral deposit. *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362. Chief Justice Hughes said (303 U. S. at 366-367):

> "In order to determine whether respondent is entitled to depletion with respect to the production in question, we must recur to the fundamental purpose of the statutory allowance. The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. *United States* v. *Ludey*, 274 U. S. 295, 302. The granting of an

arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 467. The percentage is 'of the gross income from the property,'—a phrase which 'points only to the gross income from oil and gas.' *Helvering* v. *Twin Bell Syndicate*, 293 U. S. 312, 321. The allowance is to the recipients of this gross income by reason of their capital investment in the oil or gas in place. *Palmer* v. *Bender*, 287 U. S. 551, 557.

"It is true that the right to the depletion allowance does not depend upon any 'particular form of legal interest in the mineral content of the land'. We have said, with reference to oil wells, that it is enough if one 'has an economic interest in the oil, in place, which is depleted by production'; that 'the language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.' *Palmer* v. *Bender*, *supra*. But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit. See *Thomas* v. *Perkins*, 301 U. S. 655, 661."

And he added (303 U. S. at 368):

"Undoubtedly, respondent through its contracts obtained an economic advantage from the production of the gas, but that is not sufficient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital

> investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance."

The *Bankline Oil* case was decided in March 1938. The differentiation made therein; between economic interest acquired by capital investment and mere economic advantage obtained by contract, was not reflected in the regulations that were promulgated on July 15, 1938, to implement the Revenue Act of 1938 (see Treas. Reg. 101, Art. 23(m)-1), but it was written almost literally into the first regulations under the Internal Revenue Code of 1939 (see Treas. Reg. 103, § 19.23(m)-1, dated August 23, 1939). There have been minor changes in the economic-interest vs. economic-advantage paragraph, which are duly noted in the margin;[4] we do not consider them significant in the resolution of the basic issue presented by the present case. For the years 1942 to 1951 inclusive, which cover the taxes involved in the case at bar, the regulation in force was Treas. Reg. 111, § 29.23(m)-1, which read in pertinent part as follows:

> "* * * An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal

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[4] Treas. Reg. 103, § 19.23(m)-1, was applicable to tax years beginning after Dec. 31, 1938. It was not amended in any respect presently pertinent.

Treas. Reg. 111, § 29.23(m)-1, was applicable to tax years beginning after Dec. 31, 1941. There have been two amendments here pertinent: (a) T.D. 5413, Cum. Bull. 1944, p. 124; (b) T.D. 6021, Cum. Bull. 1953-2, p. 169.

The regulation applicable to years beginning after Dec. 31, 1951, is Treas. Reg. 118, § 39.23(m)-1(a) and (b). It has not been amended in any respect now pertinent.

relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.'"[5]

It is significant that petitioners' discussion fails utterly to cite the *Ludey* case, and that it deals with the *Bankline Oil* decision only in a footnote, from which discussion of the underlying rationale of Chief Justice Hughes' opinion appears to be studiously omitted (Pet. Br. 10, note 9). We submit that the obstacles which these basic decisions place in the way of petitioners' claims do not disappear simply because it may seem convenient to ignore them.

As we will show, the concepts that were formulated in the shaping decisions set forth above became somewhat blurred in later cases in this Court, and the basic factor stressed in the decisions just discussed—that to be entitled to a depletion allowance, the taxpayer must have made a capital investment in the wasting mineral asset, so that his income represented a using up of capital, for which the allowance compensated

[5] Sec. 1.611-1(b)(1) of the proposed regulations under I.R.C., 1954, differs somewhat, but that provision has not yet been promulgated, and its ultimate form may well depend on the outcome of the present litigation.

him—that factor of capital investment was slurred over. And, in the Fourth Circuit decisions that we are about to discuss, this vital qualification was ignored, only the slogan of "economic interest" was emphasized, and accordingly the independent mining contractor, whose investment in machinery was returned to him through a depreciation allowance, received—by plain perversion of the purpose of the statute—a percentage depletion allowance in addition, based on the wasting of a mineral asset that constituted no investment on his part.[6]

Petitioners' argument (Pet. 13-15) that the purpose of the depletion allowance was to stimulate the development of natural resources and to compensate the prospector for the risks inherent in his activities will not survive examination, for a number of reasons.

First of all, the legislative materials quoted are simply individual expressions, and hence are plainly not authoritative as to the purpose or meaning of the statute. E.g., *United States* v. *McKesson & Robbins*, 351 U. S. 305, 313-315; *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, 125. Significantly enough, nothing is quoted from the committee reports cited; those do not help petitioners, and indeed are distinctly out of context in the present connection.[7]

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[6] We discuss only the right, if any, to the percentage depletion allowance granted by §§ 23(m) and 114, I.R.C. 1939. The statutory development of the depletion allowance, which culminated in the present percentage depletion method, is set forth in *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 460-461, and in *Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312, 315-318.

[7] (a) Sen. Rep. 617, 65th Cong., 3d sess., p. 6 [cited Pet. Br. 13, note 11; Pet. Br., No. 305, at pp. 15-16; Br. *A. C.* of Estate of John Schumacher, 5], deals primarily with a lower surtax for the

Next, most of the arguments that emphasize the risk factor have been adduced, not to justify the basic purpose of the depletion allowance—the reason for which has been clearly and convincingly set forth in this Court's decisions, already discussed — but to justify the amount of percentage depletion for oil and gas, which ever since 1926 has been fixed at 27½ per cent of gross income per annum.[8]

The merits of the respective arguments on that question are for Congress, and for Congress alone. Cf. Baker and Griswold, *Percentage Depletion — A Correspondence,* 64 Harv. L. Rev. 361. The point here is that there are no competent legislative materials that modify in any way the rationale of the depletion allowance laid down by this Court from 274 U. S. through 303 U. S., *supra.*

Third, even to the extent that compensation for risk may be a factor, it is simply not possible to equate the situation of a coal stripper, engaged by contract

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ultimately successful prospector, see § 211(b) of the Revenue Act of 1918; and for an increased depletion allowance to meet his situation, § 214(a)(10).

(b) H.R. Rep. 1, 69th Cong., 1st sess., p. 6 [cited Pet. Br. 13, note 11; Pet. Br., No. 305, 16] discusses only "Discovery Value" in connection with discovery depletion. The Senate amended the bill to introduce the percentage depletion method (Sen. Rep. 52, 69th Cong., 1st sess., pp. 17-18), and the House then concurred in substance (H.R. Rep. 356, 69th Cong., 1st sess., pp. 31-32 (Amendment 6)).

Plainly, neither reference has any bearing on the basic purpose of the depletion allowance.

[8] Sec. 204(c)(2), Revenue Act of 1926; Sec. 114(b)(3) of the Revenue Acts of 1928, 1932, 1934, 1936, and 1938, and of I.R.C. 1939; Sec. 613(b)(1), I.R.C. 1954.

See, in support of the statement in the text, the committee reports cited in the preceding note.

to remove the overburden from known coal lands, with that of the prospector for oil and gas, who "frequently expends many years and much money in fruitless search." Sen. Rep. 617, 65th Cong., 3d sess., p. 6. It is utterly unrealistic to suggest that the coal stripper assumes risk that is different in any degree from the risk inherent in any contracting job.

And, finally, as the opinion of the court below plainly shows, these petitioners were not exclusively engaged in coal-stripping. Their firm (R. 35) "is a contractor and over the years has engaged in road building, strip mining and the drilling of gas wells." Moreover (R. 38-39), "There has been no showing that [petitioners'] equipment was specially adapted to this job or that it would not be suitable thereafter for such other undertakings as constituted the normal and familiar business of this contractor." And, what perhaps climaxes the situation (R. 35), "Parsons * * * did not wish to be bound to a long term performance because, if opportunity should arise, it wished to return to road building."

It is simply fantastic, on the facts reflected in this record, to urge that petitioners are to be assimilated, for any purpose, to the patient prospector or the hopeful wildcatter who, after years and years of unproductive effort, finally strikes it rich.

In any event, formative cases here on depletion lend no support whatever to either the risk or the encouraging-of-prospecting rationalizations now advanced.

II. THE ESSENTIAL PREREQUISITE TO THE RIGHT TO DEDUCT FOR DEPLETION—AN ECONOMIC INTEREST IN THE MINERALS IN PLACE REPRESENTING A CAPITAL INVESTMENT—HAS BEEN DISTORTED BY THE FOURTH CIRCUIT TO THE POINT OF ABANDONMENT.

In recent cases here, efforts to distinguish between interests entitled to a depletion allowance for oil and gas and those interests not so entitled have presented substantial difficulties. The latest effort to rationalize the decisions was made in *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 313-314:

> "In determining which parties are entitled to depletion on oil and gas income, this Court has relied on two interrelated concepts which were first formulated in *Palmer* v. *Bender*, 287 U. S. 551. There, the taxpayer, a lessee of certain oil and gas properties, had transferred his interest in these properties to two oil companies in return for a cash bonus, a future payment to be made 'out of one-half of the first oil produced and saved,' and an additional royalty of one-eighth of the oil produced and saved. In upholding the taxpayer's right to depletion on all such income, the Court based its decision on the grounds that a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital.' 287 U. S., at 557.
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> "These two factors, usually considered together, constitute the requirement of 'an economic interest.' This Court has found the requisite interest in the oil in place to have been retained by the assignor of an oil lease, *Thomas* v. *Perkins*, 301 U. S. 655, the lessor of oil properties for a share of net profits, *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599, and the grantor of oil lands considered as an assignor of drilling rights,

Burton-Sutton Oil Co. v. *Commissioner,* 328 U. S. 25. The Court found no such interest in the case of a processor of natural gas who had only contracted to buy gas after extraction, *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362, and in the case of a former stockholder who had traded his shares in a corporation which owned oil leases for a share of net income from production of the leased wells, *Helvering* v. *O'Donnell,* 303 U. S. 370.

> "The second factor has been interpreted to mean that the taxpayer must look *solely* to the extraction of oil or gas for a return of his capital, and depletion has been denied where the payments were not dependent on production, *Helvering* v. *Elbe Oil Land Co.,* 303 U. S. 372, or where payments might have been made from a sale of any part of the fee interest as well as from production. *Anderson* v. *Helvering,* 310 U. S. 404."

As the Court there said (350 U. S. at 314), "The problem revolves around the requirement of an interest in the oil in place," and the earlier cases cited illustrate the complexities of that problem. Thus, in *Kirby Petroleum Co.* v. *Commissioner,* 326 U. S. 599, 605-606, the Court was required to "explain" *Anderson* v. *Helvering,* 310 U. S. 404; *Helvering* v. *Elbe Oil Land Co.,* 303 U. S. 372; and *Helvering* v. *O'Donnell,* 303 U. S. 370. Similarly, in *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U. S. 25, 29-37, the prevailing opinion was occupied with extensive "explanations" of the *Elbe Oil Land Co.,* which had just been "explained" a few months earlier in *Kirby Petroleum.* This prompted one of the Justices to say (328 U. S. at 38),

> "Nothing better illustrates the gossamer lines that have been drawn by this Court in tax cases than the distinction made in the Court's opinion

between *Helvering* v. *Elbe Oil Land Co.*, 303 U. S. 372, and this case. To draw such distinctions, which hardly can be held in the mind longer than it takes to state them, does not achieve the attainable certainty that is such a desideratum in tax matters, nor does it make generally for respect of law.'"[9]

If, as many judges have insisted, "Cases that are not argued are not well decided," then it is certainly significant that—because of the illness of counsel—*Burton-Sutton* went unargued for the Government. See J. Sup. Ct., Oct. T. 1945, pp. 195, 196, 199. No doubt the case was not intended to mark a new departure. But doctrinal fission in this Court—or what appears to be such—is all too apt to cause a chain reaction below, and soon the Fourth Circuit was relying on *Burton-Sutton* to grant depletion to a mere contractor, and thus to alter completely the basic concept of the mineral depletion allowance. *Commissioner of Internal Rev.* v. *Gregory Run Coal Co.*, 212 F. 2d 52 (C. A. 4), certiorari denied, 348 U. S. 828. Even the question was stated in terms that reflected the deviation (p. 55): "The question involved is whether the taxpayer, who mined the coal under the contracts herein described, as distinguished from the taxpayer, who held the leases on the coal land,

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[9] See *Matagorda Shell Co.*, 29 T.C. 1060, 1070: "Admittedly, to paraphrase [the foregoing excerpt], the many cases dealing with this question have drawn gossamer distinctions, which can hardly be remembered for longer than it takes to state them, between those who do and those who do not possess an economic interest in the mineral product."

Compare the remark attributed to Professor Samuel Williston in connection with a thin distinction, "I can state it, but don't ask me to repeat it."

had such an *economic interest in the operation* as to entitle it to take the deduction for depletion allowed by the federal statutes."

We have added the italics to emphasize the extent of the departure from economic interest representing a capital investment in the mineral deposit, which was the essential limitation attached to the "economic interest" concept as first formulated in *Palmer* v. *Bender*, 287 U. S. 551, and as restated by Hughes, C. J., in *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366-368 (both quoted *supra*, pp. 17-20).

And, relying on *Burton-Sutton*, the Fourth Circuit in the *Gregory Run* case then allowed the contractor a depletion allowance, concluding (212 F. 2d at 61) that, "in the pending case the rights of the producers were completely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

To the contrary, as Chief Justice Hughes was at pains to point out in the *Bankline Oil* case (303 U. S. at 367), "the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit."

The Third Circuit espoused the deviation of the Fourth in *Commissioner of Internal Rev.* v. *Mammoth Coal Co.*, 229 F. 2d 535, certiorari denied, 352 U. S. 824, and allowed depletion to a coal stripper, on the ground (p. 537) that "the interest which the stripper acquired in the case at bar was sufficiently significant to entitle

it to percentage depletion." Some stress was apparently laid on the stripper's use of machinery worth about a million dollars. But the emphasis in this Court's depletion cases is not on investment in machinery, where the owner is allowed a depreciation allowance, but on capital investment in the mineral deposit, which the stripper plainly did not have.

We need not dwell overly long on *Mammoth Coal*, because the Third Circuit in the case at bar appears now to have abandoned the aberrations of that case, and because, in the decision following *Mammoth Oil* in the reports, the Ninth Circuit emphasized and returned to the underlying concepts formulated by this Court.

That decision was *Usibelli* v. *Commissioner of Internal Revenue*, 229 F. 2d 539 (C. A. 9), which denied depletion to a stripper mining Government owned lands on the ground essentially that he had no interest by investment in the coal in place. In the course of the decision, the Ninth Circuit dispelled a widespread misconception regarding the depletion allowance, saying (229 F. 2d at 541):

> "The depletion deduction allowed by these sections is *not* to be construed, as petitioner contends, as a reward to those persons who actually mine the coal for the risks inherent in extraction. In common with industry generally those engaged in extraction of minerals on a for-hire basis receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working."

The court emphasized the basic requirement of a capital investment in the mineral in place which is

necessarily reduced as the mineral is extracted, adding (229 F. 2d at 543), "Obviously then not every person engaged in the extraction of a mineral can claim a depletable interest." The court continued (229 F. 2d at 543):

> "Certainly, the individual miners cannot be said to possess a depletable interest in the mineral even though their jobs depend upon its continued availability. Nor can the railroad transporting the coal to the breaker, or the contractor operating the breaker, claim a sufficient economic interest to warrant a depletion deduction even though exhaustion of the mineral deposit would drastically curtail their revenue. Such persons may be said to derive an economic advantage from the continued extraction of the coal,
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> 'But the phrase "economic interest" is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit.' [citing *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 367; *Helvering* v. *O'Donnell*, 303 U. S. 370, 372]"

And, concluding that (229 F. 2d at 546) "petitioner by the contract acquired an economic advantage but no economic interest in the coal in place," the Ninth Circuit approved the Tax Court's denial of a depletion allowance to the stripper.

We return again to the Fourth Circuit, which in *Weirton Ice & Coal Sup. Co.* v. *Commissioner of Int. Rev.*, 231 F. 2d 531, again allowed a stripper to deduct a depletion allowance. The court's opinion emphasizes the misconceptions on which its decision was rested.

Thus, at p. 534, the court said: "It is well established that the purpose of the depletion allowance

provisions of the statute was to encourage the exploration of natural resources which are exhausted upon recovery * * *." Not so; see pp. 22-24, *supra*, and the quotation at p. 29 from *Usibelli*. The purpose is to compensate the owner of a wasting asset for using up that asset in the course of his business, just as a factory owner is allowed a depreciation allowance on his machinery, or a professional man on his furniture.

Again (231 F. 2d at 535), "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 in the enterprise." But taxpayers who invest in "the enterprise" are not entitled to a depletion deduction, it is only taxpayers who invest in a mineral deposit who are granted that allowance.

Proceeding on those misconceptions, it is not surprising that the Fourth Circuit, following *Gregory Run* and *Mammoth Coal*, granted the contractor a depletion allowance—and held (231 F. 2d at 536) that there was no conflict with *Usibelli* because there the contractor did not have the right to mine to exhaustion! Why that factor should make any difference is not explained; nor could it be, since the allowance is available without regard to actual exhaustion. See pp. 42-44, *infra*.

In *Commissioner of Internal Rev.* v. *Hamill Coal Corp.*, 239 F. 2d 347 (C. A. 4), the same question arose in another context, because the taxpayer was the lessee, and the question was whether its depletion allowance was to be shared with its contractor, Daniel Coal Company. The taxpayer-lessee built the tipple, designated the areas to be mined, paid the contractor an agreed rate regardless of the market price, and

mined additional coal after terminating its contract with Daniel. The Fourth Circuit followed its earlier decisions and held that the contractor in those circumstances was entitled to a depletion allowance, with a consequent reduction in the allowance available to the taxpayer. The same fallacies as those heretofore exposed underlie the reasoning of the court.

E.g., "These observations [as to the details of the arrangement] are pertinent but when the whole case is considered they do not justify the conclusion that Daniel had no economic interest in the enterprise, as that phrase has been interpreted by the Courts" (239 F. 2d at 350). E.g., "In our opinion these conditions created an economic interest in the mineral in place not only in the taxpayer but also in Daniel, both of whom made a substantial investment and took a substantial risk dependent upon the successful sale of the coal" (239 F. 2d at 350-351).

But unless there is an investment in the mineral, mere economic interest in the enterprise does not establish any right to the depletion allowance; all that is then involved is "economic advantage" in the sense defined by Chief Justice Hughes in *Bankline Oil* (*supra*, pp. 19-20), and from thence carried verbatim into the regulation (*supra*, pp. 20-21).

Finally, in *Stilwell* v. *United States*, 250 F. 2d 736, the Fourth Circuit allowed depletion to the contractor with Paragon Jewel, now *amicus curiae* here, in disregard of specific findings of fact that the contract was terminable at will, and that the contractor bore no risk of fluctuating market prices. See pp. 7-8, *supra*. We think that both factors negatived any economic interest of the Stilwells in the coal, as distinguished

from economic advantage in a contract providing for extraction of the coal; and certainly the Stilwells did not invest a penny of capital in the coal deposits.

It remains only to consider the dissenting views of Judge Kalodner in the companion case of *Huss* v. *Smith* (No. 305, R. 82-85), where he declared the lessee's assumption of the risk of the market to be irrelevant, and said (No. 305, R. 84):

> "It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312."

The foregoing excerpt ignores the rationale of the depletion allowance and misstates the *Southwest Exploration* case.

Southwest Exploration represented a unique factual situation, where the taxpayer conducting the actual mining could not do so except through use of another's land, and this Court was at pains so to limit its decision. The Court said (350 U.S. at 317):

> "We decide only that where, in the circumstances of this case, a party essential to the drilling for and extraction of oil has made an indispensable contribution of the use of real property adjacent to the oil deposits in return for a share in the net profits from the production of oil, that party has an economic interest which entitles him to depletion on the income thus received."

There is no necessity now to reconsider the result in *Southwest Exploration*, but plainly it should be limited,

as this Court limited it, to the precise facts there involved. So limited, it does not help petitioners here, for two reasons: First, they cannot bring themselves within its narrow ambit. Second, as we point out below in Point IV (*infra*, pp. 47-56), Congress in 1951 made such a far-reaching change in the depletion allowance insofar as coal is concerned that the later oil and gas cases can no longer be deemed controlling in the case at bar or in any other cases involving coal.

III. THE RESULT BELOW IS CLEARLY RIGHT ON THE BASIS OF THE FACTS AND OF THE SETTLED ADMINISTRATIVE RULINGS APPLYING TO THOSE FACTS.

Petitioners here cannot prevail under any of the criteria heretofore held controlling as reasons for denying any right to percentage depletion.

A. Petitioners are not entitled to a depletion allowance because they have neither made nor acquired any capital investment in the coal in place.

First and foremost, petitioners have neither made nor acquired any capital investment in the coal they mined.

They invested in machinery (Fdg. 31, R. 21-22), and to the extent that this investment was used up in their operations, they had the right to deduct depreciation. Sec. 23(l), I.R.C. 1939; Sec. 167, I.R.C. 1954.

Petitioners also built roads and power lines in connection with their stripping activities, the cost of which was included in their compensation (Fdg. 23, R. 17-18). To the extent that petitioners' expenditures in respect of roads and power lines were properly treated as non-capital, they were plainly deductible as ordinary and necessary business expenses (§ 23(a), I.R.C. 1939; § 162(a), I.R.C. 1954); and to the extent that

such expenditures were to be regarded as capital, they were subject not only to deductions for depreciation, but also to capital or ordinary loss treatment with applicable carry-backs if these assets were thereafter disposed of for less than their book value. See generally §§ 111, 112, 117, 122, I.R.C. 1939; §§ 172, 1001, 1002, 1211, 1212, 1231, I.R.C. 1954. (It is not now necessary to particularize the provisions governing specific applications of the governing principles laid down in the sections cited.)

But petitioners did not invest any capital in the coal—the wasting mineral asset. That is to say, they did not make the particular investment that is the prerequisite to any allowance for percentage depletion. See pp. 17-22, *supra*. As the Court below said (R. 38),

> "The commitment of capital as an investment in the exploitation of a given mineral must be real and unequivocal. Otherwise, mining contractors, like contractors generally, must look to 'receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working.' See *Usibelli* v. *Commissioner of Internal Revenue, supra,* 229 F. 2d at 541."

See also the opinion of the court below in the companion case (No. 305, R. 68-69).

The Tax Court, which with some lapses[10] has steadfastly stressed the requirement of a capital investment in the mineral in place—commendable loyalty to the doctrines of this Court which has all too frequently been rewarded only with reversal by courts of

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[10] E.g., *James Ruston*, 19 T.C. 284; *Helen C. Brown*, 22 T.C. 58; *Virginia B. Coal Co.*, 25 T.C. 899; *Denise Coal Co.*, 29 T.C. 528.

appeals[11]—in one of its latest decisions has returned to the concepts first formulated by this Court. See *Nathan Fink*, 29 T.C. 1119, 1129:

> "True, petitioners had an investment in buildings, roads, and equipment. However, all of these assets were subject to an allowance for depreciation, and it is to depreciation deductions that petitioners must look for the recovery of their capital investment. To hold otherwise under the circumstances of this case where the taxpayers have no investment in the minerals in place, we would have to assume that Congress intended the depletion allowance to be a purely gratuitous benefit, over and above a reasonable allowance for depreciation, available to any taxpayer who has some 'connection' with mineral extraction and without regard to whether the taxpayer has an investment in the minerals in question.

It is of no consequence that, as the dissenting judge urged in the companion case (No. 305, R. 84), "the taxpayers depended solely upon production for their return." So did the miners whom the taxpayers employed.

Petitioners argue (Pet. Br. 22):

> "Parsons contributed far more than its tangible property. It staked its entire business operation, including its know-how, payroll and equipment, on the gamble that marketable coal could be discovered and exploited. This was its investment."

It is sufficient to say that such an investment does not measure up to the essential prerequisite for entitlement to percentage depletion, and for this simple, basic

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[11] The Fourth Circuit reversed the Tax Court's depletion rulings in the *Gregory Run* (*sub nom. J. E. Vincent*, 19 T.C. 501), the *Weirton* (24 T.C. 374), and the *Hamill* (23 T.C. 1120) cases; the Third Circuit reversed the Tax Court in *Mammoth Coal* (22 T.C. 571).

reason: It does not amount to a capital investment in the coal in place.

The question does not turn on the source of the taxpayer's income, but on the ownership of the mineral from which that income is derived. As this Court said of *Palmer* v. *Bender*, 287 U.S. 551, the case that coined the not entirely happy "economic interest" expression, "If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. Ownership was essential." *Thomas* v. *Perkins*, 301 U.S. 655, 661.

And ownership is still essential, as another regulation applicable to this case plainly shows.

Section 29.23(m)-1(i) of Treas. Reg. 111 provides in pertinent part:

> " 'The property', as used in section 114(b)(2), (3), and (4) [of I.R.C. 1939] and sections 29.23 (m)-1 to 29.23(m)-19 [of these regulations], inclusive, means the interest owned by the taxpayer in any mineral property. * * *"

We therefore ask, just what interest did petitioners own in the mineral property of the Rockhill Coal Company? The obvious answer is, None. Petitioners owned no interest in the coal property here in question because they never invested in the coal in place.[12]

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[12] Virtually identical provisions appear in the earlier and later regulations under I.R.C. 1939; see Treas. Reg. 103, § 19.23(m)-1(i), and Treas. Reg. 118, § 39.23(m)-1(i).

The foregoing regulations have since been codified in I.R.C. 1954 as § 614(a), as follows:

"(a) **General rule.**—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."

B. Petitioners are not entitled to a depletion allowance because their compensation was at a fixed price, without regard to the market, so that they were being paid simply for mining coal belonging to another rather than disposing of an asset in which they had invested and therefore owned.

A particularly important factor negativing any ownership interest in the mineral deposit is the circumstance, present here (Fdgs. 22-23, R. 15-18; R. 26-28, 35-36) and in the companion case (No. 305, Fdg. 16, R. 31; Fdgs. 27-29, R. 34; R. 41-43, 68), that the contract arrangement provided for the stripper to receive a stipulated price for all coal delivered to the landowner, regardless of its market price at the time of delivery. If the market fell, the landowner and not the stripper absorbed the loss; if it rose, the profit inured to the landowner's benefit, not to the contractor's. Such arrangements are consistent only with the notion that the owner of the land owned the coal, that he bore the burdens and the benefits of ownership as the case might be, and that the contractor was paid for the labor of extracting a mineral that belonged to another. It would indeed be a strange sort of ownership if the contractor could be insulated from fluctuations in the sale price of the product that he purportedly owns. Accordingly, a good many decisions consider a fixed price per ton a virtually conclusive criterion for denying the contractor any percentage depletion (e.g., *Morrisdale Coal Mining Co.*, 19 T.C. 208; *Matagorda Shell Co.*, 29 T.C. 1060; *Nathan Fink*, 29 T.C. 1119); and we have pointed out how the Fourth Circuit, which allowed depletion to taxpayers contracting with *amicus curiae* (*Stilwell* v. *United States*, 250 F. 2d 736), ignored the district court's finding that the contract

there involved called for a fixed price. See pp. 7-8, *supra*.

But while we agree that a fixed-price contract suffices almost automactically to bar the contractor's claim to any share in the allowance for percentage depletion, we do not accept the contrary consequence, and thus disagree with the rulings (e.g., *James Ruston*, 19 T.C. 284; *Helen C. Brown*, 22 T.C. 58; *Virginia B. Coal Co.*, 25 T.C. 894; *Walter Bernard McCall*, 27 T.C. 133) which hold that the stripper is entitled to depletion simply because his compensation for extracting the coal is measured by a percentage of the price at which it is ultimately sold.

Where the contract is thus drawn, it is true that the contractor takes the risk of the market. Most contractors do, in greater or less degree. But such a profit-sharing arrangement—or loss-sharing, as the case may be—does not supply the primary requirement that the coal deposit being depleted must represent the taxpayer's capital investment. Ownership is essential, *Thomas* v. *Perkins*, 301 U.S. 655, 661; Treas. Reg. 111, § 29.23(m)-1(i), and the circumstance that the owner of the mineral finds another to share both his risks of loss and his hopes of gain does not amount to a transfer of ownership sufficient to justify a depletion allowance for the contractor who has no capital investment in the mineral in place.

C. Petitioners are not entitled to a depletion allowance because their contracts were terminable at the will of the owner of the coal lands.

In this as well as in the companion case, the district court found that the strippers' contracts were terminable at the will of the landowner (Fdgs. 17-18, R. 13-14; No. 305, Fdgs. 30-31, R. 34-35), and both courts below

relied on this circumstance in denying the strippers any percentage depletion (R. 26, 35, 36-38; No. 305, R. 38-41, 68-69). Some rulings in other cases similarly attach considerable weight to indicia of terminability. E.g., *Usibelli* v. *Commissioner of Internal Revenue,* 229 F. 2d 539 (C.A. 9); *Nathan Fink,* 29 T.C. 1119, 1127; and compare the disregard of the finding of terminability in the *Stilwell* case, discussed at pp. 7-8, *supra.*

The dissenting judge below (R. 47; No. 305, R. 82-84) considered the right to terminate irrelevant, essentially on the ground that the possibility of termination does not affect the present existence of an "economic interest," and his view has some support in decisions which, for reasons already set out at length (*supra,* pp. 27-37), must be deemed erroneous. See *Mammoth Coal,* 229 F. 2d at 538, 539; *Weirton,* 231 F. 2d at 535.

We consider the fact of a termination right significant, not in and of itself, but as symptomatic, and for this reason: It is extremely unlikely—indeed, it would be utterly incomprehensible—that any reasonable man would invest his capital on terms that could wipe him out, at any time and without any compensation, simply at another's whim. Therefore while the absence of a termination clause does not establish affirmatively that the stripper has made a capital investment, the presence of such a clause is a conclusive indication that the stripper has not invested any capital in coal but has merely made a contract with the owner of the coal for its extraction.

To that extent, therefore, the presence of a termination clause is highly relevant, and we therefore agree

with the court below in denying petitioners a depletion allowance for that reason. We believe, however, that a sounder rationale would place more emphasis on the absence of capital investment which the termination clause reflects, and less on that clause itself.

We have already pointed out (page 24, *supra*) that in the present case petitioners insisted on a termination clause in order that they might be free to engage in other pursuits for which their experience and their equipment fitted them (R. 35; Fdg. 15, R. 12).

D. Petitioners' contracts here were non-exclusive, but the factor of exclusiveness, even if present, would not entitle them to any depletion allowance.

The findings in the case at bar show that petitioners' contract was not exclusive (Fdg. 20, R. 15), and that other contractors succeeded them in the same areas (Fdg. 29, R. 20-21); and those facts were mentioned in the opinion below (R. 35).

Certain other cases, on the other hand, have found support for a holding that the contractor had the right to a depletion allowance in the fact that he had the exclusive right to mine. E.g., *Mammoth Coal*, 229 F. 2d at 538; *Hamill*, 239 F. 2d at 350; *James Ruston*, 19 T.C. 284; *Walter Bernard McCall*, 27 T.C. 133, 136; and see the views of the dissenting judge in the companion case (No. 305, R. 84).

We think that exclusiveness *vel non* in these cases is a fact of commercial interest that has no legal significance. Obviously, it is not feasible to have two contractors with independent interests mining or attempting to mine the same area simultaneously. Any such effort in stripping operations would set off a race of diligence with dangers of violence recalling the

old-time construction of railroads by rival companies along substantially identical routes; while in drift-mining, which requires blasting to loosen the coal, non-exclusive mining would plainly be unsafe and in all likelihood fatal to all concerned.

Insofar as a non-exclusive contract contemplates, not simultaneous mining by two contractors, but termination by one followed by further operations by another, the considerations are identical with those already canvassed (pp. 39-41, *supra*) in connection with the significance of the termination clause.

E. Petitioners' contracts here did not call for exhaustion of the deposit where they were operating, but even contracts providing for mining to exhaustion do not by reason of that factor alone entitle the stripper to percentage depletion.

In the case at bar, petitioners did not have a contractual right, nor a contractual obligation, to mine the tract to exhaustion (Fdg. 18, R. 14; Fdg. 30, R. 21), and the court below relied heavily on that circumstance (R. 35, 36, 37, 38) in denying petitioners any right to percentage depletion.

In the companion case, while there was similarly no right or obligation to mine to exhaustion (No. 305, Fdg. 17, R. 31; Fdg. 31, R. 35), the stripper there did mine until by mutual agreement further work was deemed unprofitable, and the court below noted (No. 305, R. 68) that "In this sense Huss did mine the deposit to exhaustion." The court accordingly rested its denial of percentage depletion on the termination clause (No. 305, R. 68-69).

Other cases attach substantial weight to the circumstance that the contractor involved undertook, or was permitted, to mine a particular area to exhaustion.

E.g., *Mammoth Coal.*, 229 F. 2d at 538; *Weirton*, 231 F. 2d at 536; *Hamill*, 239 F. 2d at 348.

We confess ourselves unable to perceive any connection between the right to mine an area to exhaustion and the right to a depletion allowance in the mineral. The latter allowance belongs to the owner of the mineral, whose capital asset is being depleted. The circumstance that the contractor's work will eventually come to an end does not, standing alone, entitle him to an allowance for the depletion of another's capital asset which he has contracted to mine, any more than the same exhaustion factor entitles the individual miner who is employed by the contractor to deduct a similar allowance.

Most contracts for the completion of a particular job necessarily contemplate an eventual exhaustion of the work, whether that work consists of putting up a building, or of constructing a dam, or of litigating a lawsuit. But in none of those instances does the fact that the subject-matter of the contract will inevitably become exhausted give the contractor such a capital interest in the subject-matter as will entitle him to a depletion allowance for the progressive diminution of the value of his contract.

We submit that the exhaustion factor is in consequence completely irrelevant in considering whether the contractor has any right to deduct for percentage depletion. Since the rationale of the depletion allowance is, simply and solely, compensation for a capital asset acquired by investment that is being used up in the process of producing income (*United States* v. *Ludey*, 274 U.S. 295, 302, 303; *Palmer* v. *Bender*, 287 U.S. 551, 558; *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366-

367, 368; all discussed at length above, pp. 15-20), it is obvious that the decisions which stress the exhaustion factor while simultaneously ignoring the absence of any capital investment, are, very plainly, misinterpreting and misapplying the statute.

F. Petitioners are not entitled to percentage depletion under applicable Treasury regulations and interpretations.

We have already shown (*supra*, pp. 20-21) that the Treasury Regulation applicable to the present case (Treas. Reg. 111, § 29.23(m)-1) was, like its predecessor provision in Treas. Reg. 103, taken verbatim from this Court's differentiation, in the *Bankline Oil* opinion, between an economic interest acquired by investment, and a mere economic advantage resting on contract and not deriving from investment.

That regulation dates from 1939 (*supra*, p. 20), and, in essentially the same form, will govern all income taxes up to the effective date of the 1954 Internal Revenue Code. Consequently if this provision is given the weight normally accorded "regulations and interpretations long continued without substantial change" (*Helvering* v. *Winmill*, 305 U.S. 79, 83), then, plainly, the taxpayer contracting with a lessee of coal lands, be he stripper or drift miner, cannot successfully claim a depletion allowance, for two reasons:

First. Under that regulation, petitioners here have only an "economic advantage" and not a "depletable economic interest," because they have not acquired, by investment, an interest in the coal in place.

Second. Since petitioners' return does not fluctuate with the market, their income is not "derived from the severance *and* sale of the mineral"; our italics.

Treasury interpretations of the foregoing regulation similarly preclude recovery by petitioners here. Thus, in a ruling of the Bureau's General Counsel (G.C.M. 26290; Cum. Bull. 1950-1, p. 42, at p. 45), it was said:

> "It is not the view of this office, however, that the deduction for depletion is to be granted in every case. On the contrary, it seems clear that the allowance is warranted only where, under the agreement between the parties, the stripping contractor obtains a capital interest in the mineral in place and must look to the severance and sale of the mineral for the return of capital consumed in that process. (See G.C.M. 22730, supra). In this respect, it is noted that in some instances contracts may be cancelled by the coal company at will. Under such circumstances, it would appear that the contractor receives no binding right to extract the mineral and thus fails to obtain a capital interest therein. Lacking such an interest in the mineral, it follows that the contractor cannot properly claim a deduction for depletion.
>
> "In the opinion of this office, a contract which is terminable by the coal company at will, and which thus fails to vest in the contractor the requisite capital interest in the mineral in place is one in which the coal company has an absolute right to cancel at any time without cause or condition * * *.
>
> "One of the contracts examined shows that the coal company reserves the right, without payment of damages, to 'suspend' work indefinitely at any time or from time to time; under another contract the coal company is given the right, upon 5 days' notice to the contractor and without payment of damages, to 'suspend" work for an indefinite period; and under a third contract the coal company may 'suspend' operations during such time or times as the company operates at a loss

> because of the minimum payable to the contractor. Since contracts of this character, despite the power of indefinite suspension provided for therein, do not, except under specific conditions, appear to permit the coal company to dismiss contractors absolutely and substitute others to extract the minerals, it is the opinion of this office that such contracts should not be classified as contracts which may be cancelled 'at will'."

It would unduly extend this already full discussion to cite even the leading cases here on the proposition that administrative regulations and interpretations by the Treasury and the Internal Revenue Service which are consistent with a statute are entitled to substantial and often well-nigh conclusive weight. Yet in this instance the doctrine for which petitioners contend, and which some courts, notably the Fourth Circuit, have adopted (*supra*, pp. 27-33; see list of Tax Court reversals in note 11, p. 36), is wholly at variance with those regulations and interpretations over the years.

The rule that gives at least respectful recognition to administrative progress reflects the actualities of government. We submit that this rule should not be applied in every case except this one alone.[13]

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[13] It has already been pointed out (*supra*, pp. 5-8) that there are significant business and technical differences between the stripper and his expensive equipment and the drift-miner with his meager and much simpler tools. Therefore the case against allowing percentage depletion to the contractor carrying on drift-mining is an *a fortiori* one. But inasmuch as the stripper under the foregoing rationale is so very plainly without entitlement to any depletion allowance, we do not feel justified in troubling the Court with the necessarily cumulative if more dramatic factors which pertain only to the drift-miner.

This is particularly so because, as we shall now show, Congress in 1951 made such a significant change in the tax treatment of coal royalties that there is no longer any ground on which contractors can rest claims to percentage depletion.

IV. THE LEGISLATION WHICH SINCE 1951 HAS PERMITTED THE LESSOR OF COAL LANDS TO CAPITALIZE HIS ROYALTY INCOME AS A SUBSTITUTE FOR A SHARE OF THE DEPLETION ALLOWANCE CONSTITUTES AN ADDITIONAL REASON WHY A MERE CONTRACTOR IS NOT ENTITLED TO ANY PORTION OF SUCH ALLOWANCE.

For the tax years involved in the present case, the pertinent provision on which petitioners' case must stand or fall—as they and their associated petitioners fully recognize (Pet. Br. 2, 8, 28; Pet. Br., No. 305, 2, 6, 8, 19)—is the portion of § 23(m), I.R.C. 1939, which provides that "In the case of leases the deductions shall be equitably apportioned between the lessor and the lessee."[14]

But, so far as coal is concerned, the situation with respect to percentage depletion has been radically altered, by legislation which counsel in coal depletion cases do not appear to have cited, and of which the courts still appear to be unaware.

Ever since 1951, effective with respect to taxable years ending after December 31, 1950, the lessor of coal lands who is neither a co-adventurer, partner, or principal in the actual mining of the coal has been accorded capital gains or losses treatment in respect of his royalties, and in return for that boon he is denied any percentage depletion allowance. This provision was introduced by § 325(b) of the Revenue Act

[14] As has already been pointed out (note 3 at pp. 16-17, *supra*), the substance of this sentence was included in every basic revenue act from 1918 through 1954.

of 1951 as an amendment to § 117(k)(2), I.R.C. 1939. It provides as follows:

> "(2) In the case of the disposal of timber or coal (including lignite), held for more than 6 months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the amount received for such timber or coal and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber or coal. Such owner shall not be entitled to the allowance for percentage depletion provided for in section 114(b)(4) with respect to such coal. This paragraph shall not apply to income realized by the owner as a co-adventurer, partner, or principal in the mining of such coal. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determining the gross income, the adjusted gross income, or the net income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this paragraph. This paragraph shall have no application, in the case of coal, for the purposes of applying section 102 or subchapter A of chapter 2 (including the computation under section 117(c)(1) of a tax in lieu of the tax imposed by section 500)."[15]

Accordingly, when §§ 23(m) and 117(k)(2) of the 1939 I.R.C. are read together, as of course they must

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[15] In the 1954 I.R.C., this provision was reenacted as § 631(c), with a clause added to the third sentence of the 1951 text to make plain that its benefits should apply also to sublessors, viz.: "• • • and the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor." See also pp. 51-53, *infra*.

be,[16] there is no longer any depletion deduction to be "equitably apportioned between the lessor and the lessee," for the very good reason that the lessor is no longer entitled to percentage depletion. Congress amended the statute, in the face of a loss of revenue occasioned thereby, because the coal lessor was at a disadvantage under the percentage depletion method (H.R. Rep. 586, 82d Cong., 1st sess., pp. 31-32; Sen. Rep. 781, 82d Cong., 1st sess., pp. 42-43; Sen. Rep. 781, 82d Cong., 1st sess., Part 2, pp. 43-45), even with the coal depletion percentage raised from 5% to 10%, as it was by § 319(a) of the same Revenue Act of 1951, amending § 114(b)(4)(A)(ii), I.R.C. 1939.

The Senate Committee was at pains to provide that the capital-gains-treatment-in-lieu-of-percentage-depletion provisions did not apply to a lessee. Sen. Rep. 781, 82d Cong., 1st sess., p. 43.

The fact is that, since 1951, the lessor of coal lands has been placed on a footing wholly different, with respect to depletion allowance, from that of the lessor of oil and gas lands. It follows that the cases in this Court, which have dealt almost exclusively with the treatment to be accorded to the fractionalizations of leasehold interests in oil and gas, under § 23(m), I.R.C. 1939, and under identical or substantially identical predecessor provisions, cannot be mechanically applied

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[16] "There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts." *Duparquet Co.* v. *Evans*, 297 U. S. 216, 218. See also Cardozo, J., dissenting in *Panama Refining Co.* v. *Ryan*, 293 U. S. 388, 433, 439: "• • • the meaning of a statute is to be looked for, not in any single section, but in all the parts together and in their relation to the end in view. [Citing many cases]."

to what is now the very different situation of the depletion allowance in respect of coal.

Since, therefore, the coal lessor is no longer entitled to percentage depletion, there is nothing now to be apportioned, and all percentage depletion belongs indivisibly to the lessee. Accordingly, the lessee is no longer obliged to share his allowance with anyone.[17] This circumstance completely undercuts any claim by a mere contractor to any percentage depletion, for the contractor, plainly enough, cannot be assimilated to a lessor who is a participant in mining the coal.

Nor can it be contended that, as to tax years subsequent to 1950, a taxpayer who contracts with a coal lessee to mine coal on the leased property can be considered as somehow included within the term "lessee" so as to share in what since 1951 has become an indivisible allowance. For Congress well knew the difference between a lessee of wasting asset property and a contractor whose activities resulted in depleting that property.

The coal lessor's capital gains section as amended in 1951 is § 117(k)(2), I.R.C. 1939, which deals also with certain aspects of the disposition of lumber. Sec. 117(k)(1), I.R.C. 1939, which was left unchanged in 1951, provides in its first sentence:

> "If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale or

[17] The lessee computes his percentage depletion on gross income from the mining property, but must for that purpose exclude from such gross income the amount of any rents or royalties paid in respect of the property. § 114(b)(4)(A), I.R.C. 1939; § 613(a), I.R.C. 1954. To that extent his status as a lessee diminishes his allowable deduction for depletion. But, since 1951, the lessee of coal lands need no longer divide depletion, *qua* depletion.

for use in the taxpayer's trade or business) during such year by the taxpayer who owns, *or has a contract right to cut,* such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year." [Italics added.][18]

Very obviously, if Congress had intended to provide depletion benefits for one having simply a contract right to mine coal, it would have said so, instead of, by enacting § 117(k)(2), eliminating the coal lessor from the depletion provisions in § 23(m) and thus rendering the depletion allowance in the case of leases an indivisible deduction available only to lessees.

In this connection, it is significant that the restatement of the foregoing provisions in the 1954 Internal Revenue Code emphasizes in even more striking fashion the intent of Congress not to allow any percentage depletion to the taxpayer who simply has a contract to mine coal.

What was § 117(k)(1) of the 1939 Code (quoted in part, just above) became § 631(a) of the 1954 Code. The provision that was § 117(k)(2) in the 1939 Code (quoted in full, supra, p. 48) was divided in 1954 into two subsections, § 631(b) dealing with timber, and § 631(c) relating to coal.

Those latter subsections reveal significant differences.

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[18] I.R.C. 1954, § 631(a), is the same in substance as the foregoing, and indeed is nearly a verbatim copy thereof.

The last sentence of the timber subsection, § 631(b), states:

> "For the purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber."

But the coal subsection, § 631(c), provides that—

> "* * * the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor."

These distinctions, which are inherently important, become even more striking when read in the light of the indisputable fact that while coal deposits, like other minerals, are subject to percentage depletion, timber resources are not: §§ 114(b)(3), 114(b)(4), I.R.C. 1939; § 613(b), I.R.C. 1954.

That is to say, while Congress now defines the term "owner" to include the holder of a contract to cut timber, it does not define that word to include the holder of a contract to mine coal. For timber, which is not subject to percentage depletion, it is sufficient to own "an interest in such timber"; for coal, which is subject to percentage depletion, it is necessary to own "an economic interest in coal in place."

This last expression—which was only the second time that the words "economic interest" appeared in the internal revenue laws, the first being in 1951—obviously involves an incorporation of the "economic interest" concept in the sense that it was first expounded in the opinions of this Court, and in

the sense that from there it was copied literally into the Treasury Regulations (*supra*, pp. 20-21).[19]

We submit, therefore, that whether one looks to the 1954 Code, or to the 1951 amendments to the 1939 Code, or to the law as it stood before 1951, only one conclusion is possible: A taxpayer who has a contract to mine coal but who has no capital investment in the coal in place, is not entitled to percentage depletion.

All of the coal depletion cases in courts of appeals cited and discussed at pp. 27-33, 38-44, 46, *supra*, involved tax years prior to 1951, with a single exception: *Stilwell* v. *United States*, 250 F. 2d 736 (C.A. 4), dealt with taxes for the year 1952. Yet none of the three briefs filed in the latter case (C.A. 4, No. 7499) either cited I.R.C. 1939, § 117(k)(2), or discussed the changed position of the coal lessor in respect of sharing in the depletion allowance granted by § 23(m). Nor did the court.[20]

The present case and No. 305 both involve tax years prior to 1951. But we believe that the change in the

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[19] Petitioners here (Pet. Br. 10-13, 21-22) and in the companion case (Pet. Br., No. 305, 9, 11-15, 17) rely heavily on language found in *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308. But even if that decision is not limited to its precise facts, as we think it must be (*supra*, pp. 33-34), its discussion, dated 1956, can not throw light on, much less control, the meaning of an expression first employed by Congress in 1951.

[20] The same omission is noted in one of the latest of the Tax Court rulings on coal depletion. *Nathan Fink*, 29 T.C. 1119. This case involved the Finks' tax liability for the calendar years 1951 and 1952. Fink was a partner in Perry Construction Co., a firm with tax years ending April 30, 1951, and April 30, 1952. Perry had contracts to mine coal, some with Hudson Coal Co., owner of the fee, and some with Glen Coal Co., which had leased coal lands from Hudson. Plainly, therefore, the 1951 amendments to I.R.C. 1939, § 117(k)(2), were pertinent; but they were not mentioned by the court.

law just set forth, while perhaps primarily important for precluding entirely any claim to depletion by coal mining contractors for tax years after 1950 and for demonstrating in yet another aspect the error underlying the case which allowed depletion to Paragon Jewel's contractor (*Stilwell* v. *United States*, 250 F. 2d 736, *supra*), serves also to underscore the correctness of the rulings below in the cases now under consideration, and the unsoundness of the essentially contrary decisions in the Fourth Circuit.

Very frequently, of course, new legislation is deliberately designed to effect changes in existing law. On occasion, new legislation will be basically declaratory in nature. But sometimes legislation enacted subsequent to the transactions being adjudicated may be, in the words of Judge Learned Hand (*United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 429 (C.A. 2)), "considered to throw a cross light" on what has gone before.

We think that this is such a case—even though the committee reports dealing with the 1951 amendments do not mention the question of the stripper's right to depletion. Those reports could not possibly have mentioned the problem considered in the present case, for the reason that it had not then arisen.

The Revenue Act of 1951 was signed by the President on October 20, 1951. The first Tax Court decision granting a contractor any share in the percentage depletion allowance, *James Ruston*, 19 T.C. 284, was promulgated on November 21, 1952, a year later; and the first court of appeals decision giving a contractor percentage depletion (and reversing the Tax Court in the process) was the *Gregory Run* case, 212 F. 2d 52, decided on April 9, 1954.

Plainly, therefore, the framers of the 1951 amendment, where the words "economic interest" first appeared in the law, could not possibly have anticipated the misapplications of those words now in issue. But, equally plainly, the light which that amendment sheds on the depletion problem underscores both the fallacy of petitioners' position here and the misconception underlying the rationale of the Fourth Circuit cases we have already discussed at such length (*supra*, pp. 27-28, 30-33, 38-44, 46).

We submit, therefore, that the 1951 elimination of the coal lessor as a recipient of any part of the percentage depletion allowance underscores the conclusion, drawn from the seminal decisions in this Court written by Brandeis, J., Stone, J., and Hughes, C. J. (*supra*, pp. 15-20), that the underlying criteria permitting the deduction of a depletion allowance preclude the granting of any part of such allowance to one who merely contracts with the owner or lessee of the coal land, and who has never made any capital investment in the coal in place. The same conclusion follows as an *a fortiori* proposition from the terms of the 1954 Code.

Other factors, while significant (*supra*, pp. 38-44), cannot be controlling where the essential prerequisite of a capital investment in the mineral asset is not present. It is only when that integral qualification of the "economic interest" concept is abandoned, and those two words are bandied about as though they were a slogan shouted from the hustings or peddled by the hucksters, that it has been possible for courts to fall into the egregious error of allowing depletion to the contractor.

But for the economic consequences which that error threatens to wreak upon *amicus curiae*, the Fourth

Circuit's decisions on the issue now in question would represent, not only an interesting illustration of Mr. Justice Holmes' observation (*Hyde* v. *United States*, 225 U.S. 347, 384, 391) that "It is one of the misfortunes of the law that ideas become encysted in phrases and thereafter for a long time cease to provoke further analysis," but also a frightening example of how concentration on the rounded words of a non-statutory expression and disregard of the qualifying language which originally accompanied those words can lead to the complete perversion of a statute.[21]

The 1951 change in the coal depletion provisions, which frees the coal lessee from having to share his percentage depletion deduction with his lessor—the only other party with whom the statute formerly required him to participate—has made the coal lessee's deduction for percentage depletion indivisible. This change illuminates the past, and emphasizes the lack of foundation, at any time, for the contractor's claim to any part of the coal depletion allowance.

[21] Cf. *Guy* v. *Donald*, 203 U.S. 399, 406: "As long as the matter to be considered is debated in artificial terms there is a danger of being led by a technical definition to apply a certain name, and then to deduce consequences which have no relation to the grounds on which the name was applied." (Holmes, J.)

See also *Lowden* v. *Northwestern National Bank*, 298 U.S. 160, 165. "When things are called by the same name it is easy for the mind to slide into an assumption that the verbal identity is accompanied in all its sequences by identity of meaning." (Cardozo, J.)

CONCLUSION

This Court should affirm the judgment below—

1. Primarily on the ground that petitioners did not acquire by investment any interest whatever in the coal in place;

2. Alternatively, on the grounds (a) that petitioners' compensation was neither contingent nor dependent on the price for which the coal was sold, and/or (b) that petitioners' contract was terminable;

3. Additionally on the ground that when Congress in 1951 granted the lessor of coal lands capital gains treatment of his royalties in lieu of his former share in the lessee's percentage depletion allowance, it rendered the coal lessee's depletion allowance indivisible, and hence necessarily confirmed and approved the denial by the court of appeals of any depletion allowance to the contractor in this case.

Respectfully submitted.

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FEBRUARY, 1959.

APPENDIX

APPENDIX

APPENDIX A

Form of Typical Paragon Jewel Coal Lease

THIS DEED OF LEASE, . . .

. . . . . .

WITNESSETH: That for and in consideration of the premises, the said Lessors do hereby demise and lease unto the said Lessees, their heirs, successors and assigns, for the period or periods hereinafter mentioned, the sole and exclusive right and privilege of mining and removing, by deep mining or strip mining methods, or both, all of the merchantable and minable coal upon the following tracts or parcels of land, which are situated in Buchanan County, in the State of Virginia, and which are more particularly described as follows:

. . . . . .

It is further convenanted and agreed between the parties hereto as follows:

I.

The Lessees agree to pay to the Lessors a tonnage rent or royalty at the rate of fifteen cents (15¢) per ton for each and every ton of coal of two thousand (2000) pounds mined from the leased premises. The amount of tonnage royalty to be so paid for coal mined shall be determined by actual weight.

It is further agreed between the parties hereto that a minimum royalty of Four Thousand Dollars ($4,000.00) per year shall be payable to the Lessors hereunder by the Lessees on the 1st day of August, 1948, and on the 1st day of each succeeding August thereafter during the life of this contract, and that the sum of Four Thousand Dollars ($4,000.00) covering the minimum royalty for the year commencing August 1, 1948, has been paid by the Lessees to the Lessors, and receipt of which is hereby acknowledged, and such minimum rentals or royalties shall be payable whether sufficient coal to yield such minimum royalty shall be mined at the rate of fifteen cents (15¢) per ton or not. However, if the coal mined in any one

year shall not, at the rate of fifteen cents (15¢) per ton, yield the said minimum royalty, and the Lessees shall have paid the said minimum royalty for such year, then the Lessees shall have the right to mine, within a period of six (6) months in the following year, free of royalty, sufficient coal to yield the said minimum royalty paid in excess of the coal mined in such year, and that the Lessees shall have the privilege, within the next twelve (12) months from this date, of mining, free from royalty, a sufficient amount of coal which will, at the rate of fifteen cents (15¢) per ton, yield the sum of Six Thousand Dollars ($6,000.00), being the sum of money heretofore paid as minimum royalties, as hereinbefore shown. However, it is further agreed that in case the market conditions are such that the Lessees are unable to market or sell their coal, the Lessors will grant to the Lessees the privilege of relief from the minimum royalty, and exclude the payment of such minimum royalty, but for market conditions only.

II.

The tonnage royalties shall be payable on the 25th day of each month for all coal mined during the preceding calendar month, and the Lessees agree that on the 25th day of each month, they will give to the Lessors or mail to them, at their last known post office addresses, a statement showing the amount of coal mined from the leased premises during the preceding calendar month.

III.

The Lessees shall keep books of account, showing the number of tons of coal mined from the leased premises, and said books shall, at all times, during business hours, be open for inspection by the Lessors, their agents or attorneys, for the purpose of comparing and verifying the accounts rendered.

IV.

It is further agreed that the Lessees shall have the right to use all of the surface of said land as is now owned in fee simple by the said Lessors for the purpose of mining

said coal, the construction of any and all other buildings necessary for the carrying on of said mining operation. There is, however, excepted from this right or privilege granted to the Lessees the following:

• • • • • • • • • • •

V.

It is further agreed between the parties hereto that the said Lessees, their heirs or assigns, will pay all land and property taxes assessed against the property herein covered by this lease, beginning with the year 1948, and to continue during the term of this lease or for such period of time as such lease remains in full force and effect. It is agreed between the parties hereto that the said Lessees, their heirs or assigns, are hereby released from damages for injury, if any, which may result to the surface of said land by reason of the mining and removal of the said coal, with the exception of three (3) tracts above described, which are • • •

VI.

The said Lessees, their heirs or assigns, shall also pay all taxes that may be assessed against the improvements, fixtures and machinery and upon all of the coal mined during the continuance of this lease from the said leased premises.

VII.

The Lessees shall work and mine the coal in the most effectual, modern, workmanlike and proper manner and in conformity with the laws now existing or hereafter passed by the State of Virginia, or by the United States of America, regulating the working of mines, drifts, gangways, and other necessary and appropriate openings to and in the beds or veins of coal hereby leased, with openings for airways and ventilating passages for keeping the mines in good working order, to the satisfaction of the engineer of the Lessors; but in case the Lessees shall claim that the requirements of the Lessors' engineer in this regard are unreasonable, then and in that event, the

disagreement thus arising shall be settled by arbitration, as hereafter provided.

VIII.

Whenever reasonable, the Lessees shall drive the regular size of gangways and airways through such portion of said veins or seams of coal as may prove faulty, or may not yield minable and merchantable coal, and shall leave no more coal in the mine opening or workings than in the opinion of the engineer of the Lessors may be necessary and proper for the full security of the mines, and shall leave pillars and supports along the sides of the entries, gangways and elsewhere as the engineer of the Lessors shall consider necessary for such security, and shall mine and recover all of the minable and merchantable coal in said seams or veins of coal which, by the exercise of care and modern mining methods, it is practicable to recover. And any disagreement arising under this clause shall be settled by arbitration, in the manner hereinafter provided for.

IX.

The Lessees shall have the right to rob out and mine the pillars in or along any room or other working place it abandons, which in the opinion of the engineer or other proper officer or appointee of the Lessors, are not necessary to be left for the proper protection and support of the mines, and the said Lessees shall recover all of the minable and merchantable coal that, by the exercise of skill and modern mining methods, can reasonably be recovered.

X.

The said Lessees shall have the right to use the entries, haulways, or other excavations in said mine for the purpose of hauling through said land the coal leased or purchased from any other person than Lessors, but the said Lessees shall pay to the said Lessors two and one-half (2½¢) cents for each and every ton of coal acquired or purchased from any other persons than Lessors and hauled through any of

said entries, gangways, excavations, or haulways through the leased premises, and shall keep a book of accounts showing every ton of coal mined from other lands and hauled through any of the excavations, entries, or haulways on the leased premises, and pay therefor at the rate of two and one-half (2½¢) cents per ton for each ton so hauled, each month at the same time the royalties herein provided to be paid shall be due and payable. However, the Lessors do hereby grant the Lessees the right and privilege to haul Lessees's own coal purchased, owned, or leased over lands leased by Lessees from Lessors on the truckroads, or roads now on the leased premises free of charge. Provided, however, the said Lessees agree to maintain and upkeep the truck roads, or other roads at their own expense.

XI.

The Lessors, their agents, engineers, or other officers, or some other person on their behalf, with their assistants, shall have the right to enter at all reasonable times the mines and all other works on the said leased premises, whether below or on the surface of the ground, in order to inspect, examine, survey or measure the same, or any part thereof, or for any other lawful purpose, and, for those means, to use freely the means of access to the said mines and works without hinderance or molestation.

XII.

It is hereby expressly understood and agreed that all royalties which at any time may be owing to the said Lessors under this contract, shall constitute and are hereby constituted and declared a first and paramount lien upon the premises embraced in this lease, and upon all steel rails, fixtures, appliances and improvements now or hereafter placed thereon.

XIII.

It is further understood and agreed that if at any time during the continuance of this lease the Lessees should be prevented from operating the mines on the leased prem-

ises on account or by reason of general labor strikes prevailing through the Buchanan County Coal Fields, or by reason of failure on the part of the Railroad Companies, after ten (10) days notice by the Lessees, to furnish, without fault on the part of the Lessees, sufficient transportation, then and in either of those events, the minimum royalty provided for in this contract shall be abated until such time as the two causes aforesaid shall have been removed, provided, however, that in no event shall anything be construed as meaning to give relief to the Lessees as to any amount, except as to the difference between the coal actually mined and the amount of said minimum royalty, and provided, further, that there shall in no event be any abatement from said minimum royalty for either or both of the causes mentioned in this clause for a greater length of time than three (3) months in the aggregate in any one year.

XIV.

It is agreed between the parties hereto that should the operation of the mines on the leased premises be stopped by fire, and it becomes incapacitated for work by reason thereof, or solely from other providential cause, the payment of the minimum royalty hereunder shall be suspended until such time as the necessary repairs or rebuilding can reasonably be done.

XV.

If at any time, during the continuance of this lease, a dispute shall arise between the said Lessors and the said Lessees as to whether or not said mines are being worked in a skillful, suitable and proper manner, as herein provided for, or as to any other question involving the construction and effect of this lease, or any part thereof, the dispute or disputes so arising shall be referred to a board of arbitrators consisting of three competent and expert men, one of whom shall be selected by the Lessees, one by the Lessors, and one to be agreed upon by the two thus selected, and should they fail to agree within twenty-four (24) hours upon such a one, then it shall be referred to

the Judge of the Circuit Court of Buchanan County, Virginia, who shall select the third as arbitrator, and the decision of said board of arbitrators shall be final.

XVI.

It is agreed and covenanted by all the parties hereto that this lease shall take effect on the 1st day of August, 1948, and continue for the period of twenty (20) years from the said 1st day of August, 1948, and that the said Lessees, their heirs or assigns, shall have the right to renew this lease upon the same terms and provisions as those stated herein, for a further or additional period of twenty (20) years, and in the event of any such renewal, the minimum royalty for said renewal period shall be Four Thousand Dollars ($4,000.00) per year; provided the said Lessees, their heirs or assigns, shall give to the said Lessors, their heirs or assigns, at least thirty (30) days notice in writing of their intention and desire to renew said lease for said additional period of twenty (20) years, prior to the expiration of said twenty (20) year period.

XVII.

The Lessees shall deliver to the Lessors, their heirs or assigns, or one of them, within ten (10) days after the end of each six (6) months period, a blueprint of a map of the mines by a competent engineer, which shall show all coal mined by the Lessees during the last six (6) months period. Said blueprint shall show all the coal mined from the date of this lease up to the said last six (6) months period and shall also show the property lines of the leased premises.

XVIII.

It is understood and agreed between the parties hereto that in mining said coal or making any test holes or drilling any wells upon said premises for the purpose of investigating said land or mining said coal, the Lessees shall not be liable for any damages incurred by any cave-ins or the sinking of wells or springs or any other damage that might

be incurred in or by the said operations of the Lessees unless said damages be to the properties excepted as hereinbefore stipulated.

XIX.

It is further understood and agreed between the parties hereto that the said Lessees, their successors or assigns shall have the right to construct railroads, tramroads, haulroads, or tipples or other necessary structures upon said leased premises for the purpose of mining said coal and are also permitted to use any stone, dirt, water, trees or timber situate upon said premises for the purpose of mining said coal, except on those lands heretofore excepted, and shall make no payment therefor except the minimum royalties on the coal mined, hereinbefore provided for. It is further agreed between the parties hereto that the said Lessees, their heirs or assigns, may also have the same rights and privileges to the use of mining timber and other exceptions as were excepted on those tracts of surface sold and conveyed by the said • • •, now deceased, during his lifetime.

XX.

All of the aforesaid rights and privileges purported to be vested in the said Lessees are hereby granted under the terms hereof to the said Lessees, their heirs, successors and assigns, and all of the aforesaid immunities in favor of the said Lessees are and shall be in favor of the said Lessees, their heirs, successors and assigns.

This lease is executed in duplicate, • • •

XXI

The Lessors covenant that they will warrant generally the title to the coal, rights and privileges hereby leased and demised, and that they are free from encumbrances.

Witness the following signatures and seals.

• • • • • • • • • •

APPENDIX B

Form of Paragon Jewel Drift Mining Contract

THIS AGREEMENT, made this the .... day of ....., 19.., by and between Paragon Jewel Coal Company, Incorporated, a Virginia corporation, hereinafter referred to as Owner, party of the first part, and ...., hereinafter referred to as Contractor, party of the second part;

WITNESSETH:

WHEREAS, the Owner has acquired, either by purchase or lease, certain coal and the right and privilege of mining and removing the same from certain lands situate in Buchanan County, Virginia, and has heretofore had a verbal agreement with the Contractor who has been engaged as an independent contractor for the mining and placing in the tipple of the Owner, coal underlying said lands of the Owner; and

WHEREAS, the parties hereto desire to reduce to writing their said verbal agreement.

NOW, THEREFORE, for and in consideration of the covenants and agreements hereinafter made by the Owner, the said Contractor doth hereby covenant and agree as follows:

(1) To enter upon said lands of the Owner and to mine by the drift mining method in accordance with plans and specifications of the Owner, coal from the Jewell or Red Ash or such other seams of coal underlying said lands as the Owner may from time to time designate. It is understood and agreed that this is not and has not been an exclusive employment and that the designation of any coal to be mined and removed hereunder or which may have been heretofore designated to have been mined and removed has not and shall not give to the contractor the exclusive right to mine and remove the coal designated.

(2) To furnish all labor, materials, equipment and machinery which may be necessary or proper to mine, remove,

transport and place in the Owner's tipple, clean and merchantable coal mined by him hereunder in an efficient and workmanlike manner, and in complete compliance will all laws, State and Federal, now in effect or which may be hereafter enacted pertaining to the mining of coal.

(3) To take out and carry all liability and property damage insurance as will fully protect the parties hereto from any loss which may result to any person as the result of the operations contemplated hereunder, and also to take out and carry all such Workmen's Compensation insurance and unemployment or other insurance upon the employees of the Contractor as may be required by law, and to furnish unto the Owner such evidence that such liability and Workmen's Compensation insurance, or other insurance, is in effect at all times that the said Contractor may be carrying on his work pursuant hereto.

(4) The said contractor further covenants and agrees that he has looked and will continue to look solely to the personal covenant of the Owner for payment for the services heretofore rendered by him and which may be hereafter rendered by him in the mining of coal for the Owner; that he has never had and does not by virtue of this instrument acquire any economic interest in any of the coal which has been mined by him pursuant to said verbal agreement, or which may be hereafter mined by him hereunder; that the owner has had and shall continue to have the full right of percentage depletion deduction or other depletion deduction for income tax purposes or for any other purposes on all of the coal which has heretofore been or which shall hereafter be mined, produced, transported and delivered to the owner by the contractor hereunder; that the Contractor will make no claim for any percentage depletion deduction in any of his income tax returns, State or Federal, and, in the event it should be determined by any court or governmental agency, department or instrumentality, State or Federal, that he should be entitled to such percentage depletion deduction for tax purposes, he will repay to the Owner any sums that it may have lost on account of its failure to receive the whole of such per-

centage depletion deduction for tax purposes by virtue of such determination. The owner's sole right to such percentage or other depletion deduction for tax or other purposes have been taken into full account by the parties hereto in fixing the contract price hereunder.

The said Owner, in consideration of the covenants and agreements herein made by the Contractor, hereby covenants and agrees as follows:

(1) To pay unto the said Contractor the Sum of $..... per ton of 2,000 pounds for all coal mined by the Contractor hereunder and delivered to the tipple of the said Owner as herein provided, on or before Saturday of each week that the work herein contemplated shall be carried on by the Contractor. However, the Owner may alter the amount of compensation to be paid prospectively unto the Contractor for services thereafter rendered by him as contemplated herein from time to time without in any wise affecting the other provisions hereof. No such change in the amount of compensation shall be made unless and until Contractor shall have had at least three days' notice of same prior to the effective date thereof. Such payments for such services shall be based on weights at the scales located at the tipple of the Owner who shall deduct 2½% from such scale weights to cover tolerance, rejects, impurities and foreign matter in said coal, and the payments to be made to the Contractor by the Owner for his services hereunder shall be determined upon the difference between such scale weights and said 2½% deduction. The contractor shall have the right at all times to inspect the owner's scales and to test the same for accuracy.

(2) To construct and maintain all roads and power lines as may be necessary or expedient for the mining of said coal and delivering the same to the Owner's tipple.

(3) To provide and furnish all engineering services as may be necessary or proper for the mining of coal from the owner's lands and for delivering and transporting the same to the owner's tipple; it being understood between

the parties however, that the cost of certain engineering services incident to the contractor's operations have been and shall hereafter be deducted from the contract price for the coal mined by the contractor.

The parties hereto mutually covenant and agree that either may, without liability, terminate this agreement at will, with or without cause by giving to the other party notice in writing of his intention so to do. In the event of the termination of this agreement by either of the parties, the said Contractor shall have ten (10) days thereafter in which to remove from the Owner's lands all of his readily removable equipment, machinery, supplies and tools. In the event this agreement should be terminated without cause by the Owner while minable coal is still in existence upon the Owner's lands, the value of such structures or other improvements which have been placed upon the Owner's land by the Contractor as are not readily removable in the agreed amount of $..... will be paid for by the Owner at such agreed value, less normal depreciation from date of installation.

(4) The parties further mutually covenant and agree that title to all coal underlying the owner's lands is and shall remain in the owner and the contractor shall have no right to deliver or dispose of any coal produced by him from said lands to anyone other than to the owner.

It is further agreed between the parties hereto that at all times the owner shall have the right to inspect the mining operations of the contractor in order to insure that the terms and provisions of this contract are being complied with.

IT IS FURTHER UNDERSTOOD AND AGREED by and between the parties hereto that the relationship between them is in every respect that of owner and independent contractor and that this contract shall be performed accordingly.

The contractor shall not have the right to transfer or assign this agreement or any part thereof without the written consent thereto by the owner first had and obtained.

WITNESS the following signatures as of the day and year first above written.

PARAGON JEWEL COAL COMPANY, Incorporated,
a Virginia corporation,

By .....

.....

Owner

.....

.....

.....

.....

Independent Contractor

218
305

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Nos. 218 and 305

In the Supreme Court of the United States

OCTOBER TERM, 1958

ELIOTT W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
DANIEL M. FRIEDMAN,
Assistant to the Solicitor General,
MARVIN W. WHISTLER,
Attorney,
Department of Justice, Washington 25, D.C.

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

No. 305

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

Parsons, No. 218. The opinions of the Court of Appeals affirming the decision of the District Court (R. 33–39), and denying rehearing (R. 47), are reported at 255 F. 2d 595. The findings of fact, con-

clusions of law, and opinion of the District Court (R. 7–29), are not reported.

Huss, No. 305: The opinions of the Court of Appeals affirming the decision of the District Court (R. 67–70), and denying rehearing (R. 81–85), are reported at 255 F. 2d 599. The findings of fact, conclusions of law, and opinion of the District Court (R. 27–48) are reported at 150 F. Supp. 224.

JURISDICTION

The judgments of the Court of Appeals were entered on March 27, 1958 (No. 218, R. 39–41; No. 305, R. 70–72), and timely petitions for rehearing were denied on May 29, 1958 (No. 218, R. 47; No. 305, R. 85). The petitions for writs of certiorari were filed on July 25, 1958 in No. 218, and on August 25, 1958 in No. 305, and were granted on October 13, 1958 (No. 218, R. 48; No. 305, R. 86). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

The taxpayers are members of partnerships which, under contracts with the owners of coal lands, strip mined coal for delivery to the owners of the land and received therefor a fixed price per ton of coal extracted and delivered. The contracts had no fixed term, and were terminable at any time by the owners without cause merely by giving minimal notice to the stripper. The question presented is whether the taxpayers are entitled to percentage depletion deductions under Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 on the amounts re-

ceived during the taxable years for their strip mining operations.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 and of Section 29.23(a)–1 of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 41–44.

STATEMENT

In these cases, individual partners filed suits in the District Court for refund of income taxes paid upon their respective distributive shares of partnership income derived from strip mining operations,[1] on the ground that the partnership was entitled to a depletion allowance thereon. After trial, the District Court held that the partnerships did not have the requisite economic interest in the coal in place to justify depletion. The Court of Appeals affirmed, one judge dissenting from the denial of rehearing.

THE FACTS

The pertinent facts in each case, as found by the District Court and not here challenged, are as follows:

Parsons, No. 218. This case involves the taxable years 1945 through 1949, during which the partner-

[1] Strip mining is a method of extracting coal which is relatively near the surface of the land. Instead of sinking shafts and building tunnels therefrom, as is the practice in deep mining, the surface earth and rock which cover the coal is stripped off, and the uncovered coal is then removed. See G.C.M. 26290, 1950–1 Cum. Bull. 42, 43. See, also, the description of strip mining at pages 7–8 of the Schumacher Estate *amicus curiae* brief.

ship ("Parsons") strip mined coal on the property of Rockhill Coal Company ("Rockhill") (Fdgs. 5–7, 10, R. 8–11). Prior to 1943, Parsons was primarily engaged in road and highway building, and also did some strip mining (Fdgs. 3, 9, R. 8, 11); it is presently engaged in coal stripping and drilling gas wells (Fdg. 9, R. 11).[2]

Beginning in 1939, Parsons strip mined coal on Rockhill property which it had leased (Fdg. 11, R. 11). Parsons was unable to sell the coal, however, because it was oxidized, but Rockhill ascertained that it could use the coal by mixing it with Rockhill's own deep mined coal (*ibid.*). Parsons then surrendered its lease and, in February 1941, entered into a written agreement with Rockhill under which Rockhill agreed to pay Parsons a stated price per ton of coal delivered (*ibid.*; Ex. P–1, not printed). Rockhill could terminate the agreement only if Parsons violated its obligations thereunder, or if the coal could not be satisfactorily mixed with Rockhill's other coal (Ex. P–1). Parsons finished stripping the tract in 1943 (Fdg. 11, R. 11).

In February, 1942, Rockhill approached Parsons with a view to entering into another contract for strip mining a different area of Rockhill's land (Fdg. 12, R. 11). At a meeting, the parties settled upon a particular area for future stripping operations, and agreed that a written agreement would be prepared by Rockhill and submitted to Parsons for signature

[2] There were three successive partnerships which carried on the business since 1939 (Fdg. 3, R. 8). We refer to them interchangeably as "Parsons."

(Fdg. 13, R. 13). Such an agreement was prepared and on several occasions was presented to Emory Parsons (who represented the partnership in the negotiations) (Fdg. 14, R. 12). However, he refused to sign it because he did not want to be bound to an agreement requiring stripping which would take a long time, "since, if an opportunity opened up, he wanted to go back to road building work" (Fdg. 15, R. 12).

Instead, Parsons proposed to mine the designated Rockhill property under a terminable oral arrangement similar to the written 1941 contract (Fdg. 16, R. 13). Such a verbal arrangement was made, but it was terminable by either party merely on 10-days' notice (Fdg. 17, R. 13–14). However, if Rockhill terminated the contract, Parsons could remove, and would be paid for, any coal which lay under the overburden which it previously had removed, even though that took more than 10 days (Fdg. 18, R. 14).

Rockhill paid Parsons a stated price for each ton of coal delivered to Rockhill's railroad cars (Fdg. 22, R. 15–16). This price "covered all the work incidental thereto," including prospecting and mining expenses, depreciation on Parsons' equipment, building of roads, and the cost of supplies, labor, dockage, building a tipple and picking and cleaning the coal (Fdg. 23, R. 17–18).[3] The price also reflected the risk of removing overburden and finding no coal; but this "was not likely to have occurred on the Rock-

[3] During the course of the agreement, Rockhill assumed the job of cleaning the coal, and the price was correspondingly reduced (Fdg. 23, R. 18).

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hill lands, known to have coal deposits therein" (Fdg. 22, n. 13, R. 16).[4] Although the agreement provided that changes in the price paid per ton would be made only to reflect increases in labor costs, Rockhill also granted increases to reflect higher material costs (Fdg. 22, R. 15–16).[5] The price was not to vary with changes in the market price of coal (Fdg. 22, n. 12, R. 15).

Parsons had no right to, and never did, sell any coal that it mined from Rockhill property, and could not receive payment in coal instead of money (Fdg. 21, R. 15). Rockhill had the right to sell all the coal (*ibid.*).

Merely by giving 10-days' notice to Parsons, Rockhill could have put another stripper on the area which theretofore had been assigned to Parsons (Fdg. 20, R. 15). Rockhill also reserved the right to hire other strip miners to mine areas not allocated to Parsons (*ibid.*).

The areas in which Parsons was to work were allocated by Rockhill's engineering department, which had conducted preliminary surveys (Fdg. 25, R. 18–19). Parsons had discretion to determine the amount of equipment and the number of workers it would use on the allocated areas, as well as the quantity of coal

[4] All of the Rockhill property previously had been completely drilled and tested, and some of it previously had been deep mined (Fdg. 25, R. 19).

[5] On one occasion, Rockhill granted an increase when Parsons threatened to quit because it thought it could make more money by leasing out its equipment, conditioned on Parsons' building a road and opening an additional tract (Fdg. 22, n. 16, R. 16–17).

to be stripped (Fdg. 19, R. 14). However, if Parsons stripped coal at such a rate that Rockhill could not get enough deep mined coal to blend with the stripped coal, Rockhill did not have to accept the coal Parsons stripped but would have had to terminate the oral arrangement under the 10-day clause (Fdg. 19, R. 14–15). "In this manner, Rockhill controlled the quantity and quality of coal that Parsons stripped" (Fdg. 19, R. 15).

The approximate value of its equipment used by Parsons on Rockhill's property ranged from $60,000 in 1943 to $210,000 in 1946 (Fdg. 31, R. 21–22). In 1946 Rockhill began putting in its own equipment for Parsons to use, and Parsons removed some of its own equipment from the Rockhill property (*ibid.*). When Parsons stopped stripping on Rockhill property in 1950, it had there equipment worth only $125,000 (Fdg. 31, R. 22).

Parsons strip mined coal under the 1942 oral agreement until September 1950 (Fdg. 27, R. 19). On August 1, 1950, it gave Rockhill 30-days' notice that it was quitting (Fdg. 36, R. 24). However, it continued until September 5 to strip and load the coal that had been cleared of overburden (*ibid.*). After leaving Rockhill, Parsons began in the same month to strip for another company, under a lease arrangement (Fdg. 37, R. 24).

Parsons did not consider itself bound to mine the Rockhill properties to exhaustion (Fdg. 30, R. 21). When it ceased to work for Rockhill in 1950, strippable coal remained on the property (*ibid.*). Another

company continued to strip the area where Parsons had been working (*ibid.*).

Depletion was never mentioned by either of the parties to the 1942 oral arrangement (Fdg. 38, R. 24). During the time Parsons was working for Rockhill, it never requested its attorney to make an agreement under which it would have been assured of a depletion allowance (Fdg. 38, n. 37, R. 24–25). However, under the written contract which Parsons entered into with another company after leaving Rockhill (see *supra*, p. 7), it receives percentage depletion (*ibid.*). During the taxable years involved, Rockhill took the depletion deduction on the operations performed by Parsons on Rockhill land (Fdg. 39, R. 25). The Parsons' partnership tax returns did not claim depletion deductions on income earned from the Rockhill operations, although, during the same years, Parsons claimed depletion deductions on income from other property (*ibid.*).

Huss, No. 305. During the taxable years involved in this case (1944 to 1947, Fdg. 9, R. 29–30), the taxpayers were members of a partnership ("Huss") engaged in the business of strip mining coal (Fdg. 1, R. 27–28). Huss worked on land owned by the Philadelphia and Reading Coal & Iron Company ("Reading") under six written agreements with the latter (Fdg. 2, R. 28).* Five of these contracts covered a

*During the years 1944 through 1947, Huss also did strip mining for other persons, including the Stevens Company, for which it worked under periodic oral contracts (Fdgs. 4, 5, R. 28). The District Court held that Huss was entitled to depletion for income received under these contracts for the years 1945 through 1947, but not for 1944 (R. 43–47). The issue

contiguous tract (Tower City) (*ibid.*); the sixth covered an area a few miles away (Fdg. 3, R. 28).

Prior to signing the first agreement on May 27, 1944, Huss looked over the ground and moved in equipment in order to test for the presence of sufficient coal to begin strip mining (Fdg. 10, R. 30). In addition, before the five contracts covering the Tower City tract were executed, Reading furnished Huss with surface maps showing where the veins of coal were or were supposed to be (Fdg. 11, R. 30). The entire area covered by these contracts had been deep mined and the area covered by one of them had been partially strip mined, but Huss was the first to strip mine the areas covered by the other four contracts (*ibid.*). After the first contract was executed, Huss never investigated, by prospecting or test boring, before signing the other agreements (Fdg. 12, R. 30). It could see where the land previously had been mined and could ascertain the thickness of exposed veins of coal (*ibid.*).

Huss' job consisted of removing overburden from the top, drilling and shooting rock overburden, removing this overburden by means of a dragline, cleaning the coal, loading it on trucks and delivering it to the colliery (Fdg. 13, R. 30). Reading had the right, which it occasionally exercised, to place inspectors on the property to direct Huss as to the average amount of overburden to be removed in ratio to the coal (Fdg.

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with respect to 1944 was appealed, and the Court of Appeals affirmed that ruling (R. 69–70). The correctness of the ruling denying Huss depletion under the 1944 Stevens agreement apparently is not here challenged.

14, R. 31). The inspectors also checked the coal before it was loaded to determine whether it was acceptable (*ibid.*).

Under the contracts, Huss was paid a stated price for each ton of coal delivered to the colliery. All the contracts provided (Fdg. 16, R. 31; see R. 104, 105) that this price was:

> full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work * * *; also, for all loss or expense incurred for delays caused by damage to the work or materials or otherwise; also for all loss, damage or expense arising in the progress of the work from unforeseen obstructions or difficulties or other risks connected therewith * * *.

The contract prices were fixed after considering, among other things, the amount of overburden to be removed to obtain a ton of coal, the possibility of recoverable coal in the tract, and the length of the haul from the tract to the point of delivery (Fdg. 25, R. 33). Negotiations as to contract prices were conducted on Reading's behalf by its engineer in charge of stripping in the area (Fdg. 26, R. 33). His recommendations with respect to a suggested contract price were based on a company study estimating the future market price of coal, the fixed costs, and an amount designed to insure a reasonable margin of profit (*ibid.*).

The contracts provided for an increase or decrease in the price paid corresponding to a change in labor

costs (Fdg. 27, R. 34). Except when labor costs changed, Huss was paid the same price per ton of coal without regard to whether or not Reading sold the coal, the price at which it did so, and the market price of coal (Fdg. 28, R. 34).

The coal did not belong to Huss, which had no right to sell it even if Reading rejected it (Fdg. 29, R. 34). If Reading agreed, Huss could negotiate a sale of coal to another colliery, but the sale would be on Reading's behalf; Reading would collect the purchase price, and Huss would receive only the per ton price stated in its contract (*ibid.*).

The contracts required Huss to strip mine coal as long as no more than a specified ratio of cubic yards of overburden per gross ton of raw coal recovered was present (Fdg. 24, R. 33). When this ratio was exceeded, mining would usually be unprofitable, and Huss was not required to mine (*ibid.*). However, if Huss thought the contract price warranted its doing so, it could continue to work after the stated ratio had been reached, and on occasion did so (*ibid.*). The contract, however, did not specify any fixed duration (Fdg. 31, R. 35).

Reading, in its discretion, could cancel and terminate the contracts prior to the completion of stripping merely by giving Huss 30-days' written notice (Fdg. 30, R. 34).[7] It could also suspend operations under

[7] See *e.g.*, Article 23, under which Huss agreed that Reading "shall have the right to entirely cancel and terminate this contract, without specifying any reason therefor, upon thirty (30) days' notice in writing * * *" (R. 139). One of the contracts (P-22) permitted immediate cancellation (R. 98-99).

the contracts for not more than five weeks; if the suspension continued for a longer period, Huss could then cancel the agreement (R. 98–99, 139–140).

Huss determined when and where to begin and to stop mining in a particular area, and whether it would be profitable to begin to mine (Fdg. 17, R. 31). However, Huss was not paid for prospecting costs covering an area which it decided not to mine (*ibid.*).

In order to get equipment to the first job site, Huss spent $10,000 to $15,000 (which included the cost of its own employees) for building roads and moving equipment (Fdg. 19, R. 31). Two shovels were moved 3½ and 1½ miles, respectively, under their own power (Fdg. 19, R. 31–32). The other Tower City areas were contiguous and, except for some equipment which was purchased, Huss moved equipment from one tract to another (Fdg. 19, R. 32). No equipment was permanently affixed to any of the tracts and all could be removed (*ibid.*). The trucks and bulldozers used were suitable for work other than coal stripping, although other equipment was not (*ibid.*).

About $100,000 worth of equipment, which was not acquired solely for the Reading job, was used initially on the Tower City tract (Fdg. 21, R. 32). By the end of 1947, Huss had about $500,000 worth of equipment on the job, but the same equipment (except for one machine) had been used on stripping contracts for other persons (*ibid.*). At the end of 1947, when Huss ceased stripping these tracts, all of its equipment used thereon was either moved to other properties, or was sold (Fdg. 20, R. 32).

Huss paid for all of the equipment, supplies, labor and materials used on the Reading job (Fdgs. 18, 22, R. 31, 32). However, it took deductions on its tax returns for all of those items as ordinary and necessary business expenses, and also received depreciation deductions on that equipment (Fdg. 22, R. 32).

After about three weeks of stripping, Huss was producing some tonnage from the area covered by the first contract, but about two months passed before it got sufficient tonnage to show a small profit (Fdg. 23, R. 33).

Huss continued to strip mine under the contracts until the stipulated ratio of overburden to coal was reached, at which point operations became unprofitable (Fdg. 31, R. 35). The contracts were then cancelled by mutual agreement (*ibid.*). Reading never exercised its right to terminate or suspend operations (*ibid.*).

THE DECISIONS OF THE COURTS BELOW

In each case, the District Court held (No. 218, R. 29; No. 305, R. 47) that the taxpayers, in conducting their respective stripping operations for Rockhill and Reading, "did not acquire an economic interest in the coal in place, entitling them to the depletion allowance on their gross income derived therefrom * * *." The two cases were considered at the same time on appeal and the Court of Appeals, in affirming, wrote its principal opinion in *Parsons*.

It there ruled (No. 218, R. 34), in an opinion by Judge Hastie, that although "the economic interest in coal in place which will support a percentage depletion

allowance for strip mining need not amount to an estate or tenancy as understood in the law of real property * * * it must be something more than an independent contractor's normal right to the benefit of his bargain and the kind of 'interest' which that right always gives him in the subject matter of the contract." After reviewing the "unchallenged" "facts found by the district court" (R. 35), it concluded (R. 36) that "what the parties agreed and what they did disclose the partnership act[ed] only as an ordinary independent contractor in mining the Rockhill tract." It emphasized two facts: (1) that the partnership could not sell or dispose of the coal itself, but was entitled only to the stated price from Rockhill, which did not fluctuate with the market; and that there was "no significant difference" in the terms "for payment to the partnership for its work" from "the normal payment to an independent contractor for accomplishing an agreed result"; (2) that the partnership had no right to, and did not, mine the tract to exhaustion; that the "terminability of the agreement on short notice was an essential and significant part of the bargain"; and that "the partnership contemplated and bargained for no economic interest in the mineral it agreed to extract beyond the independent contractor's normal concern with any subject matter with which he is to work for an agreed price" (R. 36–37). The court also stated (R. 39) that it is "very doubtful whether investment in equipment of general utility in a contractor's business [the only kind of investment which Parsons made in the Rockhill job] is the type of capital expenditure which can properly be found

to constitute an investment in a particular mineral deposit which the contractor has undertaken to work."

In its opinion in *Huss*, the court stated (No. 305, R. 68) that none of the compensation arrangements "suggest[s] that the stripper acquired an interest in the mineral in place"; that the trial court had not erred in viewing the coal company's "absolute right of termination on thirty days' notice as more significant than the fact that this privilege was not exercised in the given case" (R. 69); and that "[n]othing appears which distinguishes" Parsons' commitment of "about $500,000 worth of equipment to this job" "from capital expenditures normally made by independent contractors who undertake large projects in such familiar fields as road building and general construction" (*ibid.*).

SUMMARY OF ARGUMENT

Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 permit, as a deduction from gross income, "a reasonable allowance for depletion" which, in the case of coal mines, is limited to five percent of "gross income from [mining]." "A taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the [coal] in place,' and (2) secured by legal relationship 'income derived from the extraction of the [coal], to which he must look for a return of his capital.'" *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 314.

In these cases, the taxpayers entered into agreements with the owners of coal lands under which, in return for a fixed price per ton of coal delivered to the owner, they conducted strip mining operations on

the property, *i.e.*, they stripped off the earth and rock which covered coal near the surface, and then removed it. Since, if they had an interest acquired by investment in the coal in place, they would have had to look to income derived from its extraction for their return of capital, the second criterion for depletion would here be satisfied. The narrow question, therefore, is whether, by their contractual arrangements with the mine owners to conduct strip mining operations, the taxpayers "acquired, by investment, any interest in the [coal] in place."

A. Contrary to petitioners' contention, the depletion allowance is not intended to stimulate production of minerals and provide compensation for the risk therein. Its "fundamental purpose" is to provide "compensation to the owner for the part" of "wasting" "mineral deposits" which are "used up in production" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366); it is "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired" (*Southwest Exploration* case, *supra*).

B. In order to be entitled to depletion, petitioners must establish that they had "a capital investment in the [coal] in place which is necessarily reduced as the [coal] is extracted" (*Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, 603). The requirement that the taxpayers have an "economic interest" (*Palmer* v. *Bender*, 287 U.S. 551, 558) in the mineral in place is not satisfied, however, through "a mere economic advantage derived from production,

through a contractual relation to the owner, by one who has no capital investment in the mineral deposit" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 367). We submit that the Court of Appeals correctly held that the strippers were "acting only as an ordinary independent contractor in mining the [areas]" (No. 218, R. 36; see No. 305, R. 69); and that they, therefore, did not have any economic interest in the coal in place, but only a "mere economic advantage derived from production."

C. 1. One who contracts to perform services in connection with the extraction of minerals does not acquire an economic interest in the minerals in place merely because his compensation is based upon the volume of mineral extracted, or because he furnishes substantial equipment and supplies for the job. In order to obtain depletion, the arrangements between the parties must be such that the payments were not merely compensation for the performance of an employment contract, but represented a partial return of the stripper's capital investment in the mineral in place, which is being depleted by extraction.

We submit that a stripper can not have an economic interest in the coal in place where he does not have the right to remove a substantial and significant portion of that coal. That essential condition is absent here. In the instant cases, the strippers' contracts were terminable without cause by the mine owners on minimal notice. The taxpayers' right to extract coal, therefore, was in fact so tenuous as to be illusory. They were, by analogy to real

property law, only tenants at sufferance; they merely had employment contracts under which they could continue to work as long as the coal company was satisfied with their services.

It is well settled in other areas of tax law that the existence of an absolute right of termination may preclude the vesting of rights and obligations which might otherwise arise. Similarly, in the case of depletion, the existence of the right to terminate the strippers' rights without cause is completely inconsistent with the concept of an economic interest in the coal in place.

As long as the mine owners had the right to terminate without cause on short notice, it is immaterial whether the right ever was exercised. For in determining whether the strippers had the necessary interest in the coal in place, the crucial factor is what their rights were when the relationship was established.

2. But even if the coal owners' right to terminate without cause does not itself preclude an economic interest in the coal in place, it is difficult to see how the taxpayers made any capital contribution which would constitute the acquisition of such an interest "by investment" (*Southwest* case, *supra*). As the Court of Appeals pointed out (No. 305, R. 69), their capital outlays appear indistinguishable "from capital expenditures normally made by independent contractors who undertake large projects in such familiar fields as road

building and general construction." They could recover all of these expenditures through normal deductions for ordinary and necessary business expenses and depreciation. They had no right to keep or sell any part of the coal; their sole right was to remove it and turn it over to the coal companies in return for a stated price per ton. On their face, and in actual operation, the strip mining agreements were no more than ordinary employment contracts, by which the taxpayers strip mined coal under what, in effect, was a piecework method of compensation.

3. To the extent that the strip miner is allowed a depletion deduction, there must be a corresponding disallowance of the deduction to the owner of the property. The statutory provisions for depletion "must be read in the light of the requirement of apportionment of a single depletion allowance" (*Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312, 321). A pertinent inquiry, therefore, is whether the mine owners, by their contractual arrangements with the strippers, fairly can be said to have given up a part of their ownership of the coal in the ground, so that a portion of their depletion allowance should be shifted to the contractors. We submit that the mine owners did not give up any part of their ownership interest in the coal by permitting the strippers to mine it pursuant to arrangements under which the owners retained the right to terminate the operation at will, and the strippers had no right to dispose of the coal for their own account.

ARGUMENT

TAXPAYERS ARE NOT ENTITLED TO PERCENTAGE DEPLETION DEDUCTIONS ON THEIR GROSS INCOME FROM STRIP MINING OPERATIONS

Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 41–42) permit, as a deduction from gross income, "a reasonable allowance for depletion" which, in the case of coal mines, is limited to five percent "of the gross income from [mining]" during the taxable year. Under the principles governing the allowance of depletion in the extractive industries (developed by this Court in connection with the oil business), "a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the [coal] in place,' and (2) secured by legal relationship 'income derived from the extraction of the [coal], to which he must look for a return of his capital.'" *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 314; *Palmer* v. *Bender*, 287 U.S. 551, 557–558.

In the instant cases, the taxpayers entered into arrangements with the owners of coal lands under which, in return for a fixed price per ton of coal delivered to the owner, they conducted strip mining operations on the property. Since their income from these operations depended solely on the amounts which they were to receive from the owners for the coal which they extracted, the second requirement for a depletion allowance would here be satisfied, namely, that any return of the taxpayers' capital must come from "income derived from the extraction" of the mineral.

The narrow issue in these cases, therefore, is whether, by their contractual arrangements with the mine owners to conduct strip mining operations, the taxpayers "acquired, by investment, any interest in the [coal] in place," Petitioners contend (*Parsons* Br. 12; see *Huss* Br. 10–11, Schumacher *amicus curiae* Br. 4, 18) that they acquired such an interest when they obtained the "right to mine" the coal "and be paid for it"; and that they made the necessary capital investment in the coal by committing their organization, equipment, and skill to the task of extracting it. "But the tax law deals in economic realities, not legal abstractions * * *." (*Southwest Exploration* case, *supra*, p. 315); and we submit that "closer analysis" (*ibid.*) of the relationship between the taxpayers and the owners of the coal lands shows, as the Court of Appeals held, that the taxpayers were "acting only as an ordinary independent contractor in mining the [areas]" (No. 218, R. 36; see No. 305, R. 69), and, therefore, did not acquire, by investment or otherwise, any interest in the coal in place.

Since this case involves the application to the mining industry of the depletion principles developed in the oil industry, we believe that it would be helpful at the outset briefly to indicate the theory of the depletion allowance and the standards which govern its application. We shall then show that, under these standards, the taxpayers did not acquire, by investment, any economic interest in the coal in place. On the contrary, they had only the "mere economic advantage derived from production, through a contract-

ual relation to the owner," that is enjoyed by any employee or independent contractor who is employed to perform a particular task in return for a stated compensation, but who has "no capital investment in the mineral deposit" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 367).

A. THE DEPLETION DEDUCTION IS DESIGNED TO PERMIT THE TAX-FREE RECOVERY OF A CAPITAL INVESTMENT IN A WASTING ASSET WHICH IS EXHAUSTED THROUGH EXTRACTION. IT IS NOT INTENDED TO PROVIDE AN INCENTIVE FOR THE DEVELOPMENT OF MINERAL RESOURCES, OR TO COMPENSATE FOR RISKS INHERENT IN THE MINING INDUSTRY.

The "fundamental purpose of the statutory allowance" for depletion is to provide "compensation to the owner for the part" of "wasting" "mineral deposits" which are "used up in production" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366). It is "based on the theory that the extraction of minerals gradually exhausts the capital investment in the mineral deposit" (*Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312), and is allowed "as compensation to the owner for the part used up in production" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366). It is "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired" (*Southwest Exploration* case, *supra*, p. 312). Since "gross income from mining" is taxed as ordinary income rather than as a capital gain (*Burnet* v. *Harmel*, 287 U.S. 103), the depletion allowance thus serves the same purpose of permitting a tax-free recovery of the raw material (the mineral)

as the deduction in manufacturing of the cost of the raw material as part of the cost of the goods sold. It is analogous to the depreciation deduction allowed for tangible physical assets used in a taxpayer's trade or business. See *United States* v. *Ludey*, 274 U.S. 295, 302–303.

Initially, the depletion allowance was based on the taxpayer's capital investment in the mineral, and then on the value of the mineral in place. See *Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312, 315–319. However, in 1926 Congress adopted the present system of "granting an arbitrary deduction * * * of a percentage of gross income * * *" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 367). While "[t]he present allowance * * * bears little relationship to the capital investment, and the taxpayer is not limited to a recoupment of his original investment" (*Commissioner* v. *Southwest Exploration Co.*, *supra*, p. 312), this fact "in no way altered the fundamental theory of the allowance," namely, that it is "compensation to the owner for the part" of his "capital investment in the mineral deposit" which is "used up in production" (*Bankline* case, *supra*, pp. 366–367, 368).

Petitioners are thus in error in contending that the purpose of the depletion allowance is to "stimulate the development of natural resources and compensate the operator for the risks inherent in his business" (*Parsons* Br. 13), or to "stimulate prospecting, exploration and production of minerals" and provide a "reward * * * for the assumption of the inherent risks of discovery and extraction" (*Huss* Br. 15, 16; see Schumacher *amicus curiae* Br. 7). The element

of risk in a particular transaction is provided for by the parties in the price which they set. For example, in these cases the prices paid by Rockhill and Reading reflected various risk factors, including the possibility that, upon removing the overburden, marketable coal might not be recoverable. See No. 218, R. 16; No. 305, R. 33. The fact that some extractive industries are more risky than others is reflected in the varying percentages of gross income which are allowed for depletion. Compare the 27½ per cent allowed for oil and gas depletion with the lower rates for minerals. Internal Revenue Code of 1939, Sections 114(b)(3) and (4). But "[t]he depletion deduction * * * is *not* to be construed * * * as a reward to those persons who actually mine the coal for the risks inherent in extraction. In common with industry generally those engaged in extraction of minerals on a for-hire basis receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working." *Usibelli* v. *Commissioner*, 229 F. 2d 539, 541 (C.A. 9) (emphasis in original; footnote omitted).

B. IN ORDER TO OBTAIN A DEPLETION ALLOWANCE, A TAXPAYER MUST HAVE A CAPITAL INVESTMENT IN THE MINERAL IN PLACE. A MERE ECONOMIC ADVANTAGE DERIVED FROM PRODUCTION IS NOT SUFFICIENT

In *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, this Court recently pointed out (p. 313) that, "[i]n determining which parties are entitled to depletion," it "has relied on two interrelated concepts which were first formulated in *Palmer* v. *Bender*, 287

U.S. 551." It stated (p. 314) that *Palmer* held that "a taxpayer is entitled to depletion where he has:

> (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital.' "

and that

> [t]hese two factors, usually considered together, constitute the requirement of "an economic interest."

Palmer v. *Bender* held that the owners of oil and gas leases, which they transferred to oil companies in return for bonuses and future royalties, were entitled to depletion thereon. The Court pointed out (p. 558) that the owners of the leases acquired "complete legal control of the oil in place" and therefore "acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute";[8] that when the lease owners transferred their operating rights thereunder to the oil companies "they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor"; that "throughout their changing relationships with respect to the properties, the oil in

[8] In *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, the Court previously had held that a lessee of iron ore lands was entitled to depletion. The Court stated (p. 369) that although the leases "did not convey title to the unextracted ore deposits," they did create a "very real and substantial interest therein" which "is property," namely, they gave the lessee "the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership * * *."

the ground was a reservoir of the capital investment of the several parties"; and that "[p]roduction and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests."

The issue in *Palmer* v. *Bender,* therefore, was not whether the taxpayer had *acquired* an economic interest in the oil in place (since it was clear that it had done so by acquiring the lease), but whether, by reservation of royalties upon transfer of the lease, it had *retained* such an interest. The case accordingly affords no support to petitioners, since the issue here is not whether they retained an economic interest in the coal in place, but whether they acquired such an interest in the first place.

Most of the subsequent decisions by the Court in this field, including *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U.S. 25, upon which *Huss* relies (Br. 11), similarly involved the question whether the particular interest retained gave the transferor or assignor an economic interest in the oil in place. Those decisions, therefore, did not involve the issue in the instant cases—whether there was an initial acquisition of an interest in the mineral in place—since in those cases the transferors "once had at least a fee or leasehold in the oil-producing properties themselves" (*Commissioner* v. *Southwest Exploration Co.,* 350 U.S. 308, 315). The issue in those cases was whether the second criterion for an "economic interest" was satisfied—that is, whether the receipt of further income by the transferor was dependent solely on production, so that only

the mineral itself could be looked to as the source for recovery of that part of the original capital investment that was represented by the retained interest. They include such cases as *Thomas* v. *Perkins*, 301 U.S. 655, *Anderson* v. *Helvering*, 310 U.S. 404, and *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599. But even in those cases the Court reiterated the basic criterion of a capital investment in the mineral in place. For example, in *Kirby*, it stated (p. 603) that

> The test of the right to depletion is whether the taxpayer has a capital investment in the oil in place which is necessarily reduced as the oil is extracted.

and (p. 606) that

> a share in "net profits," disassociated from an economic interest, does not entitle the holder to a depletion allowance.

In two cases in which a depletion allowance was denied, the Court drew the distinction, which we believe is crucial in the cases at bar, between an "economic interest" in the mineral in place and a mere "economic advantage" unaccompanied by any interest in the mineral. In *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, the Court held that a processor of gas was not entitled to a depletion deduction on the basis of its agreement to purchase gas at the well head, since it had no economic interest in the gas in place. It stated (pp. 367, 368):

> * * * the phrase "economic interest" is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who

> has no capital investment in the mineral deposit. * * *
>
> * * * * *
>
> Undoubtedly, respondent through its contracts obtained an economic advantage from the production of the gas, but that is not sufficient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance.

In *Helvering* v. *O'Donnell*, 303 U.S 370, the taxpayer sold one-third of the stock of an oil company (San Gabriel), in return for one-third of the net profits from the operation of the oil and gas properties of San Gabriel, which the purchaser of the stock agreed to acquire. The Court held that the taxpayer was not entitled to a depletion deduction on his share of the net profits. It stated (p. 372):

> As consideration for the sale of his stock in the San Gabriel Company respondent bargained for and obtained an economic advantage from the Midway Company's operations but that advantage or profit did not constitute a depletable interest in the oil and gas in place.

In *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, this Court for the first time allowed depletion to a party who, prior to the transaction involved, had had no fee or leasehold interest in the mineral. There Southwest was a lessee under a State lease which entitled it to extract offshore oil belonging to California. The oil was produced by slant drilling operations conducted from upland property, configuous to the

offshore oil, not owned by Southwest. California permitted offshore oil drilling only from the contiguous uplands; Southwest did not have any interest in such lands. In return for permitting it to drill on the uplands, Southwest agreed to pay the uplands owners a share of the net profits of the operation.

This Court held that the upland owners were entitled to depletion on their share of the net profits from the operation. Pointing out (p. 315) that without the participation of the upland owners "there could have been no bid, no lease, no wells and no production," it held that since the upland owners were "essential parties" to any drilling operations (p. 316) and had made "an indispensable contribution" to the production of oil (p. 317), their "contribution [the use of their land] was an investment in the oil in place sufficient to establish their economic interest" (p. 316). It "decide[d] only that where, *in the circumstances of this case,* a party essential to the drilling for and extraction of oil has made an indispensable contribution of the use of real property adjacent to the oil deposits in return for a share in the net profits from the production of oil, that party has an economic interest which entitles him to depletion on the income thus received" (p. 317, emphasis added).

In effect, the Court in *Southwest* assimilated the position of the uplands owners to that of a lessor. Realistically, the uplands owners had the same degree of control over the exploitation of the oil deposits as a lessor has over mineral lands which he leases. Since California law in effect made the uplands an integral part of the oil deposit (for, without such lands,

the oil could not be extracted), the uplands owners already had an economic interest in the oil at the time they granted the taxpayer the right to use their land for drilling. When they did so, they yielded control over the mineral; but they retained the same kind of economic interest in the oil in place that a lessor of mineral lands retains when he leases them.

In the instant cases, however, Parsons and Huss had no control of the coal prior to their stripping contracts with the coal companies. They were neither "essential" to the extraction of the coal, nor did they make any "indispensable contribution" of land or otherwise. For, unlike the situation in *Southwest*, where without the right to use the uplands Southwest could not have obtained the lease on the offshore oil deposits, in the cases at bar the coal companies could either have removed the coal themselves, or hired some other contractor to strip mine the tracts.

In sum, the test of the right to depletion (assuming that the income is derived solely from production of the mineral, as is the case here) is whether the taxpayer has a capital investment in the mineral in place, or merely an economic advantage derived from production. That standard also is reflected in Treasury Regulations 111, Section 29.23(m)–1 (Appendix, *infra*, pp. 42–44). While in some of this Court's decisions the crucial issue was whether the taxpayer's income was derived solely from production, these were cases in which the original capital interest in the mineral in place was clear. As we shall now show, in the instant cases the taxpayers acquired no interest, legal or other, in the mineral in place, invested no capital there-

in, and therefore did not have the requisite economic interest to justify a depletion allowance.

C. PETITIONERS HAD NO CAPITAL INVESTMENT IN THE COAL IN PLACE; THEY HAD MERELY AN ECONOMIC ADVANTAGE DERIVED FROM PRODUCTION

In determining whether particular taxpayers had the necessary "economic interest" in the mineral in place to entitle them to a depletion allowance, this Court has looked to the "fundamental purpose of the statutory allowance" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366) of "permit[ting] a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired" (*Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312).[9] The inquiry here, therefore, is whether petitioners had "a capital investment in the [coal] in place which is necessarily reduced as the [coal] is extracted." (*Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, 603). We submit that the courts below correctly answered this question in the negative. For neither Parsons nor Huss had any "economic interest" in the coal in place; they had only "a mere economic advantage derived from production, through a contractual relation to the owner," similar to that of any independent contractor "who has no capital investment in the mineral deposit" (*Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 367).

1. One who contracts to perform services in connection with the extraction of minerals does not

[9] See, also, *Palmer* v. *Bender*, 287 U.S. 551, 557–558; *Herring* v. *Commissioner*, 293 U.S. 322, 325–328.

acquire an economic interest in the minerals in place merely because the compensation is based upon the volume of mineral extracted, or because he furnishes substantial equipment and supplies for the job. In order to obtain depletion, the arrangements between the parties must be such that the payments were not merely compensation for the performance of an employment contract, but represented in part a return of the stripper's capital investment in the mineral in place, which is being depleted by extraction.

Apart from the situation where the stripper has an ownership interest in the coal, as in the case of a lessee or one who has the right to sell the coal for his own account, we submit that a stripper cannot have an economic interest in the coal in place where he does not have the right to remove a substantial and significant portion of that coal. To obtain an economic interest in the coal in place, a stripper must at least have the right (1) to mine all or a substantial portion of the tract, (2) to extract a substantial number of tons of the mineral, or (3) to continue stripping operations for a sufficient time so that he can be certain of being able to remove a substantial amount of coal. See G.C.M. 26290, 1950–1 Cum. Bull. 42. For otherwise there is no real nexus between the stripper's capital investment and the mineral in place.

Necessarily, the stripper does not have such a right in relation to the mineral if the coal owner can terminate the contract without cause on short notice. For a stripper's right to extract coal, assuming that it otherwise meets the test of substan-

tiality, is illusory if subject to immediate termination without cause. He is, by analogy to real property law, only a tenant at sufferance, subject to removal at any time and for any reason by the coal owners. In these circumstances, the stripper cannot be said to have any real capital investment in the coal in place; he has merely an employment contract under which he can continue to work as long as the coal company is satisfied with his services.

It is well settled in other areas of tax law that the existence of an absolute right of termination may preclude the vesting of rights and obligations which might otherwise exist. For example, an *inter vivos* transfer of property with a retained right to revoke the transfer leaves the transferor taxable on the income from the transferred property, just as though he owned the property. See Sections 166 and 167 of the Code (26 U.S.C. 1952 ed., Secs. 166 and 167). The right to revoke a purported gift prevents the transfer from being a completed gift for gift tax purposes. *Burnet* v. *Guggenheim,* 288 U.S. 280. Similarly, if there exists the power to revoke or terminate an *inter vivos* transfer, there has not been a sufficient transfer of the property to exclude it from the transferor-decedent's gross estate for estate tax purposes. See Section 811(d)(1) of the Code (26 U.S.C. 1952 ed., Sec. 811); *Commissioner* v. *Estate of Holmes,* 326 U.S. 480. The reason for attaching significance to the right to revoke, of course, is simply that for all practical purposes the rights otherwise conferred, or the obligations otherwise assumed, may be disregarded when they can be nullified at any time. This

principle is no less applicable in the depletion field than in other tax fields.

As long as the coal company has the right to terminate without cause on minimal notice, it is immaterial whether that right ever was exercised. For in determining whether the stripper acquired an economic interest in the coal in place, the crucial factor is what the relationship was when the stripping arrangements were made. Since the right to terminate at will is inconsistent with the concept of any real interest in the coal in place, the requisite economic interest could not subsequently come into being *nunc pro tunc* because the coal company did not exercise its rights of termination.

Similarly, it is beside the point whether, as *Huss* states (Br. 12), the termination provision was inserted in its contracts solely to enable the coal company to discharge an unsatisfactory operator. For as long as the coal company has the absolute right to terminate, the reasons which led it to insist upon that right are immaterial. On their face, the Huss contracts unqualifiedly permitted Reading to terminate without cause; and it is not disputed that, whatever may have been the reasons for inclusion of that provision, Reading at any time could have terminated Huss' services if it became dissatisfied with them.

The *Parsons* taxpayers are in error in arguing (Br. 18–19) that a termination clause merely affects the value of the stripper's interest. Of course, it does affect the value of whatever interest the stripper has; but it also determines the extent of that interest and its relationship to the coal in place. A power to

terminate the contract, being essentially a power to revoke all rights and obligations as to the stripper, makes the contract only a terminable contract of employment and precludes the stripper from acquiring any interest in the coal in place.

The *Parsons* taxpayers also suggest (Br. 16–17) that the terminability of a strip mining contract is without significance because in *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308, the contracts of the upland owners, who were held to have an economic interest in offshore oil in place, were also terminable. But there termination of the agreements would also have caused termination of the production of the offshore oil. The upland owners' interests were, for all practical purposes, co-terminous with the production of the offshore oil. Hence, in that case there was present what is lacking here: a substantial nexus between the taxpayer's capital investment and the mineral in place. In contrast, the termination of a strip mining contract does not necessarily stop the extraction of coal; it permits the coal company to bring in a new contractor to continue the operation, or to perform the work itself.

We reiterate the basic proposition that, in order to be entitled to a depletion allowance, the taxpayer must have an interest in the mineral *in place*. A mere interest in the mineral after it has been extracted is not enough; for only if the interest is in the mineral in place can it be said that the taxpayer's capital is being exhausted as the mineral is depleted.

Thus, contrary to taxpayers' assumption (*Huss* Br. 11, 16; *Parsons* Br. 12, 13, 22), the question is not

whether they made an "investment" in connection with their strip mining contracts, or what the amount of such investment was. Concededly, Parsons and Huss made an investment in their strip mining operations. But this was no more than the normal investment which an independent contractor ordinarily makes when he is employed to do a job. The same kind of investment would be made by someone engaged in excavating, razing or, as Parsons had done prior to the instant contracts with Rockhill, in road building. But such an investment, without the concomitant right to remove a substantial amount of the mineral, does not create an interest in the mineral in place. The distinction is that drawn by this Court in *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, between an "economic interest," which represents a capital investment in the mineral in place, and a mere "economic advantage derived from production" which is insufficient to justify depletion (see *supra*, pp. 27–28).

Since it is clear that both Rockhill and Reading had the absolute right to terminate the strippers' contracts on minimal notice (see *supra*, pp. 5, 6, 11), we submit that the strippers did not acquire any economic interest in the coal in place by virtue of their strip mining agreements. The lower courts, including the court below in these cases (No. 218, R. 36–37; No. 305, R. 68–69), have generally taken this position. *Commissioner* v. *Mammoth Coal Company*, 229 F. 2d 535 (C.A. 3), certiorari denied, 352 U.S. 824; *Stilwell* v. *United States*, 250 F. 2d 736 (C.A. 4); *Usibelli* v. *Commissioner*, 229 F. 2d 539 (C.A. 9); *Clifton* v. *Commissioner*, decided April 21, 1958 (1958 P–H T.C.

Memorandum Decisions, par. 58,065); *Morrisdale Coal Mining Co.* v. *Commissioner,* 19 T.C. 208; *Fink* v. *Commissioner,* 29 T.C. 1119, now pending on appeal to the Third Circuit; *C. A. Hughes & Co.* v. *Commissioner,* decided March 9, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,051); see also, G.C.M. 26290, *supra.*[10]

2. But assuming *arguendo* that the coal owners' right to terminate without cause does not itself preclude the existence of an economic interest in the coal in place, there is an additional reason why the taxpayers are not entitled to depletion. In *Southwest,* this Court stated that to have the requisite "economic interest" for depletion, a taxpayer must have "acquired, by investment," an interest in the mineral in place (350 U.S. 308, 314). It is difficult to see how Parsons and Huss made any capital contribution which would constitute such an investment. As the court below pointed out in *Huss* (No. 305, R. 69), the kind of capital outlays which the strippers here made appear indistinguishable "from capital expenditures normally made by independent contractors who undertake large projects in such familiar fields as road building and general construction." The taxpayers could recover the cost of the equipment which they furnished through depreciation deductions or on

[10] While the Fourth Circuit at one time deemed the existence of the right to terminate immaterial (*Weirton Ice & Coal Sup. Co.* v. *Commissioner,* 231 F. 2d 531, 534-535; *Commissioner* v. *Hamill Coal Corp.,* 239 F. 2d 347), its most recent decision in this field stated: "A most important factor is the terminability of the taxpayer's rights" (*Stilwell* v. *United States,* 250 F. 2d 736, 739).

a sale;[11] the cost of the services which they supplied was deductible, and thus recoverable tax-free, as ordinary and necessary business expenditures (Internal Revenue Code of 1939, Section 23(a)); and, moreover, there was no indication that the equipment which they used was so uniquely designed for these particular projects as to preclude its use elsewhere[12]—a factor which might indicate that there had been a capital investment in the mineral. Furthermore, the strippers' organization and skill obviously did not diminish in value through their employment on these jobs; if anything, they became more valuable through experience.

Parsons and Huss had no right to exploit the coal

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[11] Section 23(l) of the Code (26 U.S.C. 1952 ed., Sec. 23) provides for a deduction in the amount of "A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) * * * of property used in the trade or business" and the annual deduction therefor is normally taken on the adjusted cost basis of the property (see Sections 113(a) and (b)(1) and 114(a) (26 U.S.C. 1952 ed., Secs. 113 and 114)). If the property is sold, the cost thereof, as adjusted for depreciation and other factors, is excluded in computing gain or loss. (See Sections 111(a) (26 U.S.C. 1952 ed., Sec. 111), and Section 113(a) and (b)(1).

[12] The District Court found in *Huss* (No. 305, Fdgs. 20, 21, R. 32) that the equipment which Huss originally used on the Reading job was "not acquired solely for that contract"; that, except for one machine, all of the approximately $500,000 worth of equipment which Huss had on the job by the end of 1947 "had been used on other coal stripping contracts not with Reading"; and that at the end of 1947 Huss' "equipment was either moved on to other properties or sold." In *Parsons*, as the Court of Appeals pointed out (No. 218, R. 36), there was similarly "no indication that the partnership equipment had utility only for this [Rockhill] job or was specially adapted to it."

on their own account; they could not keep or sell any part of it.[13] Their sole right was to remove the coal and turn it over to the coal companies in return for a stated price per ton. On their face, and in actual operation, the strip mining agreements were no more than ordinary employment contracts, by which Parsons and Huss strip mined coal under what, in effect, was a piece-work method of compensation.

3. Under Section 23(m) of the Internal Revenue Code of 1939, the depletion allowance must be "equitably apportioned between the lessor and lessee" of mineral property. Percentage depletion is allowed, under Section 114(b) of the Code, on the "gross income from the property" and, in the case of mines, is limited to five percent of such income. To the extent that the strip miner is allowed a depletion deduction, there must be a corresponding disallowance of the deduction to the owner of the property. See *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 309.[14] The statutory provisions for depletion "must be read in the light of the requirement of apportionment of a single depletion allowance" (*Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312, 321).

A pertinent inquiry in these cases, therefore, is whether the mine owners, by their contractual arrangements with the strippers, fairly can be said to have

[13] Compare the contrary situation in *North Range Mining Co.* v. *Commissioner*, 46 B.T.A. 296, where a firm which undertook to mine a certain amount of iron ore for the lessee of iron mines could sell excess ore for its own account.

[14] Section 114(b)(4) excludes from the gross income from mining which is subject to depletion "an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property."

given up a part of their ownership of the coal in the ground, so that a portion of their depletion allowance should be shifted to the contractors. To put the question in these terms is to answer it. For we think it clear that the mine owners have not given up any part of their ownership of the coal by permitting the strippers to mine it pursuant to arrangements under which the owners retained the right to terminate the operation at will, and the strippers had no right to dispose of the coal except to them. The arrangements did not result in any transfer of the coal companies' ownership of the coal in place to the strippers; and the strippers did not acquire any economic interest in such coal, but only the economic advantage which any independent contractor has in the "subject matter with which he is to work for an agreed price" (No. 218, R. 36–37).

CONCLUSION

The judgments of the Court of Appeals, sustaining the denial of depletion allowances to petitioners, should be affirmed.

Respectfully submitted,

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FEBRUARY 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions

* * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

For percentage depletion allowable under this subsection, see section 114(b), (3) and (4).

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) [as amended by Sec. 145, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 124 (a) and (c), Revenue Act of 1943, c. 63, 58 Stat. 21] *Basis for Depletion.*—

* * * * *

(4) *Percentage depletion for coal* * * *

(A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

* * * * *

(B) *Definition of Gross Income from Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(m)–1. *Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Tim-*

ber; Depreciation of Improvements. Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

* * * * *

When used in these sections (29.23(m)–1 to 29.23(m)–28, inclusive) covering depletion and depreciation—

* * * * *

(c) The term "mineral deposit" refers to minerals in place. * * *

* * * * *

(f) "Gross income from the property," as used in section 114(b) (3) and (4) and sections

29.23(m)–1 to 29.23(m)–28, inclusive, means the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade before such transportation or processing. * * *

* * * * * *

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IN THE

Supreme Court of the United States

October Term, 1958.

No. 218.

EMORY W. PARSONS, ERMA M. PARSONS, et al.,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

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ARGUMENT.

In arguing that Parsons had no economic interest, Respondent and Paragon Jewel Coal Company ("Paragon"), as amicus curiae, have raised certain points which warrant a brief response.

The crucial fact which Respondent has ignored is that Parsons is a coal operator in the business of mining coal. In previous cases involving the existence of an economic interest, the issue before this Court has invariably involved one who did not actually participate in mining, but in some fashion received income dependent upon the success of a mining operation performed by another. This circumstance has led to the consideration whether there is, as Respondent describes it (Br. 35), "a substantial nexus" between that person and the mineral in place. Here, however, it is the miners themselves who seek the depletion. It is difficult to conceive of a person having a closer connection to, and interest in, the mineral than the one who has the right to mine it and convert it to cash.

A. The Fact That the Parsons' Contract Was Terminable Is Irrelevant.

1. Respondent concedes that a stripper's contract right to extract coal may constitute an economic interest in the coal, even though his contract is terminable.[1] He argues, however (Br. 32), that if the contract is terminable, it constitutes an economic interest only if the stripper has the right to remove a "substantial and significant" portion of the deposit. This argument proceeds from a fundamental misconception of the depletion allowance.

Contrary to Respondent's belief (Br. 22-23), we do not dispute the fact that the purpose of the depletion deduction is analogous to depreciation. Both are intended to

1. Since he nowhere expressly relies upon the fact that Parsons was paid a stated price per ton, Respondent apparently concedes it to be irrelevant.

recompense taxpayers as their assets are worn out or used up. However, the Respondent misses the significant difference between the two deductions: the manner in which this basic purpose is achieved.

Originally depreciation and depletion were exactly the same. In both the basis to be depreciated or depleted was the cost paid by the taxpayer. In 1918, however, the depletion statute was amended to provide that taxpayers could use as their basis the value of the mineral deposit.[2] Under this "discovery value" depletion the taxpayers' deductions related to what they acquired, and not (as in the case of depreciation) what they had paid. This permitted them to recover through depletion deductions far more than their cost. As this Court said in *Palmer v. Bender*, 287 U. S. 551,558 (1933):[3]

> "The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of the discovery rather than at its original cost."

To remove the difficulty of valuing hidden deposits, Congress enacted[4] percentage depletion as an administra-

2. Revenue Act of 1918, §§ 214(a)(10), 234(a)(9), 40 Stat. 1067-8, 1078-9.

3. The Committee reports cited in Petitioners' principal brief state that the intent of Congress in enacting discovery value depletion was "to stimulate prospecting and exploration," S. Rep. No. 617, 65th Cong., 3d Sess. 6; "to encourage the wildcatter or pioneer", H. R. Rep. No. 1, 69th Cong., 1st Sess. 6; and "to stimulate prospecting for new deposits of mineral and oil," S. Rep. No. 27, 69th Cong., 1st Sess. 3. Accordingly, Congress gave mineral producers a larger basis than other taxpayers upon which to compute deductions for exhaustion. We do not contend that this fact alone establishes taxpayers' right to depletion. We do urge, however, that in determining the existence of such right, it is significant that Parsons, being the miner who bore the risk of discovery, is within the class which Congress intended to benefit.

4. Revenue Act of 1926, § 204(c)(2), 44 Stat. 16 (oil and gas); Revenue Act of 1932, § 114(b), 47 Stat. 202-3 (coal).

tive substitute for discovery depletion. Under percentage depletion it is unnecessary to determine the value of the mineral interest acquired. The deductions continue as long as the taxpayer derives gross income from the property, irrespective of its value.

Thus a taxpayer may have a capital investment in the mineral which will support depletion even though he has paid nothing for it. In addition, whether the interest is "substantial and significant" is irrelevant. The comparative value of the interest relates only to its size and not to the creation of it in the first instance.

Respondent does not say what is a "substantial and significant" portion of the coal. By whatever standards the determination is to be made, the rule can lead only to hopeless confusion unless arbitrary determinations are to be sanctioned. Respondent ignores the inherent difficulty in determining a stripper's rights in relation to a hidden coal deposit, the extent of which is unknown. Indeed, Respondent's test harks back to the days of discovery value depletion and revives the type of administrative burden which Congress sought to remove by the enactment of percentage depletion.

2. Respondent seeks to distinguish the *Southwest* case on the issue of terminability by saying that in that case termination would have brought an end to production, whereas here production might be continued by another operator (Br. 35). In fact, Southwest had the right to modify as well as terminate its state lease without liability to the upland owners and, upon a change in the California law, could have terminated the agreement with the upland owners and continued to produce oil. The upland owners had no assurance that they would receive net profits as long as oil was produced. Contrary to Respondent's assertion, the termination of the agreements with the upland owners would not necessarily stop production. Hence the distinction which he seeks to make fails. In any event, as this

Court said in *Southwest*, the possibility of termination never occurred. 350 U. S. at 316.

B. Parsons Acquired an Economic Interest, Not an Economic Advantage.

1. Respondent relies heavily (Br. 27-30) upon two decisions of this Court holding that the taxpayers there involved had no economic interest in the mineral, but had only an "economic advantage". *Helvering v. Bankline Oil Co.*, 303 U. S. 362 (1938); *Helvering v. O'Donnell*, 303 U. S. 370 (1938). These cases are two examples of those involving taxpayers who were not actual producers of the mineral. In the *Southwest* case the Court indicated the basis for decision of such cases: taxpayers who are not actual producers have an economic interest only if they contribute something essential to production, either in the form of the land under which the mineral lies, or, as in the *Southwest* case, an asset without which the mineral cannot be mined. The taxpayers in *Bankline* and *O'Donnell* did neither. In short, they had nothing whatever to do with production, and in the words of the statute as applied to coal, they received no "gross income from mining". Accordingly, they acquired merely an economic advantage from a third party's mining operation. In the present case, of course, there is no need for such inquiry; the taxpayers are in fact the miners.

2. Despite the fact that it is the miners themselves who are here involved, Respondent nevertheless argues (Br. 30) that the taxpayers contributed nothing essential to production because the owners might have contracted with different operators. But any lessor of coal or oil lands may choose any person as lessee. Indeed, in the *Southwest* case itself it appears that although the upland owners were essential to production as a class, no one of them was essential individually. The oil operator could have chosen equally among six upland owners, but used the land of only three.

The only question is whether what was in fact contributed was essential to the mining. It is obvious that the contribution of the miner himself is essential. His rights cannot depend upon whether some other operator might have mined the coal.

C. Respondent's Alternative Argument Constitutes a Repudiation of the Announced Position of the Treasury Department, as Well as His Own Prior Position.

Respondent argues alternatively (Br. 37) that even if its contract were not terminable, Parsons nevertheless made no "capital contribution which would constitute . . . an investment" in the mineral in place.[5] The thrust of this argument would reach all strippers.

Parsons and Huss are not unique. Their equipment is the same kind as that committed by the operators in every other stripping case presented to the courts. In net effect, Respondent argues that no stripping contractor is entitled to depletion.

This position is not only contrary to the Treasury Department's published ruling in GCM 26290,[6] but is likewise

5. Similarly, Paragon contends that the taxpayers cannot have an economic interest in the property because their interest was not acquired by capital investment. Although Paragon uses the words "capital investment" over three score times in its brief, it never defines them. In such circumstance, it is fair to inquire what "capital investment" Paragon has in its coal arrangement. Paragon is a lessee of coal lands, and its lease requires it to pay taxes and royalties. It also incurs expenses in building roads, tipples and otherwise preparing the property for drift mining. The royalties and taxes paid by Paragon are, of course, deductible for tax purposes, and its other expenditures in respect of the property are either subject to depreciation or directly deductible as expenses. Paragon asserts that expenses of this type are not sufficient to support the taxpayers' capital investment. By its own admission Paragon has nothing more or different invested in its lease than the taxpayers in their stripping contracts. If the taxpayers have no capital investment, neither does Paragon.

6. 1950-1 Cum. Bull. 42.

contrary to Respondent's position in every case in which he supported the right of the coal stripper to depletion. *E.g., Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535 (3d Cir. 1955), *cert. denied*, 352 U. S. 824 (1956); *Commissioner v. Gregory Run Coal Co.*, 212 F. 2d 52 (4th Cir. 1954), *cert. denied*, 348 U. S. 828 (1954). It conflicts also with every decided coal stripper case, all of which have assumed that strippers can have an economic interest.[7]

D. Section 631(c) of the Internal Revenue Code of 1954, First Enacted in 1951, Clearly Has No Relevance to the Present Issue.

Proceeding on the erroneous premise that "petitioners' case must stand or fall" on the provision of the statute requiring equitable apportionment of the depletion deduction between lessor and lessee, Paragon asserts (Br. 47) that legislation first enacted in 1951, and now appearing as Section 631(c) of the Internal Revenue Code of 1954, constitutes an "additional reason" why the taxpayers are not entitled to depletion.

We agree that no party—government, coal company or strip miner—and no court has ever made this point. We think the reason is plain: the legislation in fact has no relevance to these cases. Even though Respondent makes no reference to the point in his brief, we believe that some brief comment is appropriate.

1. Parsons' right to depletion does not depend upon the existence of the equitable apportionment provision in the statute dealing with lessors and lessees. The depletion allowance must be apportioned among all parties having an economic interest in the property. *Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312 (1934). As this Court said in *Palmer v. Bender*, *supra* at page 557, the lessor-lessee apportionment provision of the statute "presupposes that the deductions may be allowed in other cases."

7. The same, of course, is true of Paragon's position.

2. The legislation to which Paragon refers simply provides that the disposition of coal with a retained economic interest by an owner who is not engaged in mining shall be treated as if it were a sale, even though it would not qualify as a sale under general principles. Gains are treated as capital gains, and losses are fully deductible. Since the transaction is treated as if it were a sale, percentage depletion would not be allowed to the seller whether or not the statute said so.

The tax treatment accorded a passive owner of coal who is not engaged in mining obviously can have no bearing on the tax treatment of one engaged in mining, whether as lessee or otherwise, particularly where by its very terms the statute is expressly inapplicable to persons so engaged. Although Paragon characterizes the lessee's depletion as "indivisible" (Br. 50), it recognizes that a lessee today receives precisely the same amount of depletion he received prior to the enactment of this statute. In short, the statute has no effect on the depletion of a lessee or anyone else except the passive owner not engaged in mining.

3. Paragon points to the difference between the definition of an owner in subsection 631(b) of the Internal Revenue Code of 1954, dealing with timber, and subsection 631(c), dealing with coal. It asserts that the difference demonstrates that Congress did not intend "to allow any percentage depletion to the taxpayer who simply has a contract to mine coal" (Br. 51). This difference demonstrates no such intent. On the contrary, it is necessary because of a basic difference in the two subsections which Paragon apparently overlooks. The coal subsection applies only to owners who are not engaged in mining. The timber subsection is not so limited. One deriving income from a contract to mine coal is not covered by the statute. He is engaged in mining. Manifestly, he could not be included in the definition of an owner to be covered by the statute. To do so would be self-negating on its face.

4. Paragon concedes (Br. 54) that the Committee reports dealing with the 1951 amendments do not discuss the right of a strip miner to depletion. Since the legislation has nothing to do with the question, any discussion of it would be clearly irrelevant. However, Paragon says that the "reports could not possibly have mentioned the problem considered in the present case, for the reason that it had not then arisen." This ignores GCM 26290, which was issued in March, 1950 for the precise purpose of setting out the Treasury Department's position on the coal stripping depletion problem. Clearly, when the 1951 legislation was considered, the strip miner's problem was there for all to see.

5. Finally, whatever inference Paragon seeks to draw from its assertion (Br. 52) that the words "economic interest" first appeared in the statute in 1951 must fail. The words "economic interest" first appeared in the law in the Revenue Act of 1943.[8] All that was done in the Revenue Act of 1951 was to add rules respecting the tax treatment of a disposition of coal by a non-miner to an existing section of the law originating in 1943 which contained the words "economic interest."

CONCLUSION.

The decision of the Court of Appeals should be reversed.

Respectfully submitted,

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8. Revenue Act of 1943, § 117(k)(2), 58 Stat. 47.

No. 305

AUG 25 1958

JAMES R. BROWNING, C

IN THE

Supreme Court of the United States

October Term, 1958.

No.

GEORGE HUSS,

Petitioner.

v.

FRANCIS R. SMITH, Collector of Internal Revenue for the First District of Pennsylvania,

Respondent.

No.

RUSSELL HUSS,

Petitioner.

v.

FRANCIS R. SMITH, Collector of Internal Revenue for the First District of Pennsylvania,

Respondent.

No.

WESLEY HUSS,

Petitioner.

v.

FRANCIS R. SMITH, Collector of Internal Revenue for the First District of Pennsylvania,

Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1958.

No.

GEORGE HUSS,

Petitioner,

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,

Respondent.

No.

RUSSELL HUSS,

Petitioner,

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,

Respondent.

No.

WESLEY HUSS,

Petitioner,

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA,

Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

George Huss, Russell Huss and Wesley Huss pray that writs of certiorari issue to review the judgments of the

United States Court of Appeals for the Third Circuit entered on March 27, 1958, in three cases, namely, *George Huss v. Francis R. Smith*, *Russell Huss v. Francis R. Smith*, and *Wesley Huss v. Francis R. Smith*, all of which involve identical questions.

OPINIONS BELOW.

The three cases with respect to which writs of certiorari are sought were heard together in the United States District Court for the Eastern District of Pennsylvania, and were consolidated for hearing before the Court of Appeals. The Findings of Fact and Opinion of the District Court (42a) are reported at 150 F. Supp. 224. The Opinion of the Court of Appeals (Appendix B, *infra*, page 18) is reported at 255 F. 2d 599. The Opinion of the Court of Appeals denying petitioners' petition for rehearing (including dissenting Opinion of Hon. Harry E. Kalodner) (Appendix D, *infra* page 25) is reported at 255 F. 2d 601.

The Court of Appeals referred to its Opinion in *Parsons, et al. v. Smith*, (Appendix F, *infra*, page 31), reported at 255 F. 2d 595. The taxpayers in the *Parsons* case have filed a petition for writs of certiorari with this Court.

JURISDICTION.

The judgments of the Court of Appeals, (Appendix C, *infra* pages 22-24) were entered on March 27, 1958. A petition for rehearing, timely filed, was denied on May 29, 1958 (Appendix E, *infra* page 30).

Jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

QUESTION PRESENTED.

Did the taxpayers, who acquired from the owner of certain coal bearing lands exclusive contractual rights to discover and strip mine the coal thereon, have an economic interest in the mineral entitling them to the statutory depletion allowance with respect to the coal mined by them even though (1) taxpayers' contractual rights were regarded by the Court of Appeals as terminable by the owner although not terminated in fact, and (2) taxpayers did not participate in the ultimate sale price of the coal, although they bore the entire risk of discovery and production and depended for their profit upon production of the mineral, which the landowner had agreed to buy at a stated price per ton?

STATUTES AND REGULATIONS INVOLVED.

The statutes involved are Sections 23 (m), and 114 (b)(4) of the Internal Revenue Code of 1939, 26 U. S. C. (1952 ed.) Sections 23 (m) and 114 (b)(4), and the Regulations involved are Treasury Regulations 111, 26 C. F. R. Sections 29.23 (m)-1 (1949). These are printed in Appendix A, *infra* pages 15-17.

STATEMENT OF THE CASE

A. The Facts.

These actions were brought by the petitioners in the United States District Court for the Eastern District of Pennsylvania against the Collector of Internal Revenue pursuant to 28 U. S. C. Section 1340, to recover refunds of income taxes paid with respect to the calendar years 1944 to 1947, inclusive.

In the taxable years involved, petitioners were partners engaged in mining Anthracite by the strip-mine method. From 1944 through 1947 they had income from mining under rights obtained from the Philadelphia and Reading Coal and Iron Company (hereinafter called "Reading") under five written agreements dated May 27, 1944, February 23, 1945, May 8, 1945, July 16, 1945, December 17, 1945, and July 19, 1946. (42a).

Under the terms of these contracts, which were substantially alike, the arrangements were called "salvage" projects. Reading "reserved" specific areas for petitioners, and granted to them the exclusive right to strip all coal which could be discovered in those areas. In each contract, Reading agreed to pay a stated price per ton of coal actually delivered to it. In fixing the contract price, market value was taken into consideration. (Finding of Fact No. 26, 48a). Reading expressly provided against responsibility for discovery of coal or any quantity of coal. Petitioners assumed all risk in connection with prospecting, discovery and recovery of coal and the operation of the entire stripping project, including all tools, materials, power, transportation, labor, and facilities. (36a-37a). Petitioners determined when and where to begin and to stop mining, and whether it would be profitable to begin strip mining. They were not entitled to any payment or to reimbursement of costs if they did not succeed in producing coal. (Finding of Fact No. 17, 46a). Their sole possi-

bility of return was the price per ton which Reading agreed to pay for delivered coal. Petitioners built roads, and commenced stripping operations with equipment of the value of about $100,000; by the end of 1947, they had increased their equipment investment to about $500,000. (Findings of Fact Nos. 18-21, 46a-47a). Most of this equipment was not suitable for other than strip mining (21a).

Each of the contracts contained a provision permitting Reading to terminate on notice (39a). No contract was terminated unilaterally by Reading; however, each was terminated by a written mutual agreement between Reading and petitioners after petitioners completed stripping thereunder (Finding of Fact No. 31, 50a). The termination provisions were inserted to permit Reading to sever relationship with unsatisfactory strip miners without resort to legal proceedings (10a-12a).

B. Decisions of the Courts Below.

The District Court concluded, on the foregoing facts, that petitioners did not have an economic interest in the mineral in place with respect to the coal produced by them in the taxable years because (1) the contracts with Reading were terminable by Reading on thirty days' notice (2) Reading had agreed to pay a stated price per ton of coal delivered, without regard to fluctuation in the market price, and (3) the coal remained an asset of Reading.

The Court of Appeals affirmed the judgments of the District Court. It declared that there was nothing about the method of compensation to suggest that petitioners had acquired an economic interest in the mineral in place. The Court recognized that the parties contemplated such extensive mining as to justify characterization of petitioners' status as involving the requisite economic interest. Indeed, the Court stated that "recent decisions of the Court of Appeals for the Fourth Circuit suggest the reasonableness of such an analysis on facts not very different from those here." Nevertheless, since the Court regarded as "vague"

the standard which must be administered in these cases, it determined that a result contrary to that reached in the Fourth Circuit was justifiable on the ground the matter was within the reasonable discretion of the district judge, citing as an example that the district judge could view the right of termination as more significant than the fact that it was not exercised. The Court further noted that despite the substantial investment of petitioners in equipment, and despite the fact that such equipment had utility for stripping operations only, nothing distinguished such expenditures from ordinary capital expenditures by independent contractors who undertake large projects.

The Court of Appeals denied petitioners' application for rehearing. A dissent was filed by Hon. Harry E. Kalodner. Judge Kalodner pointed out that the petitioners had control over production and depended upon production for the possibility of return on their investment. Accordingly, the specific standard laid down by this Court in its most recent decisions had been met, and the decision of the Court of Appeals in these cases conflicts with the decisions of this Court, with those of the Court of Appeals for the Fourth Circuit, and with a prior decision of the Court of Appeals for the Third Circuit.

C. Petitioners' Position.

This Court only recently, in *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308 (1956) reiterated the standard to be applied in depletion cases: an economic interest in the mineral in place exists where the taxpayer has acquired, by investment, any interest in the mineral in place, and secured by legal relationship income derived from the extraction of the mineral, to which he must look for a return of his capital. As stated in *Burton-Sutton Oil Co., Inc. v. Commissioner,* 328 U. S. 25, 34 (1946), a taxpayer has an economic interest in the mineral in place through control over extraction, and depletion depends upon production.

Petitioners had the exclusive right to extract the coal in the areas specified; they bore the risk of discovery and production; they actually produced the mineral and had income therefrom; and they were dependent solely upon production for their possibility of return. It is petitioners' position that they have met exactly the requirements specified by this Court for entitlement to the depletion allowance, and that they satisfy the intended objective of the statutory allowance: to compensate those who bear the risk of discovery of the mineral.

The Court of Appeals was in error in determining that the standard involved was vague, and that the undisputed facts presented an area in which different conclusions may properly be reached on the same facts. It was further in error in extending the requirement of dependence upon production to include the risk of fluctuation with the market, in holding that the possibility of termination of petitioners' contracts was a relevant consideration in the taxable years, and in suggesting the absence of a "capital investment" by petitioners in the mineral deposit. On substantially similar facts, the Court of Appeals for the Fourth Circuit allowed the depletion deduction to the strip miner. In this, the Fourth Circuit was correct and consistent with the determinations of this Court. The same result should have been reached here.

REASONS FOR GRANTING THE WRITS.

1. The Decision of the Court of Appeals Is in Conflict With the Decisions of this Court.

Only recently this Court was constrained to meet the problem of entitlement to the depletion allowance under 28 U. S. C. Sections 23(m) and 114(b)(4). *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308 (1956). The issue was resolved upon a reaffirmation of principles expressed in *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25 (1946); *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599 (1946); and *Palmer v. Bender*, 287 U. S. 551 (1933).

Despite the unequivocal expression of principles and the clear direction as to their application contained in the *Southwest Exploration* decision, the Court of Appeals stated that the standard to be applied was vague, and concluded that the matter was one for the reasonable discretion of the trial court, although this would, and did, lead to differing tax results upon substantially similar facts.

This Court in the *Southwest Exploration Co.* case declared that a taxpayer has an economic interest in the mineral in place, the prerequisite to the statutory depletion allowance, where he has (1) acquired, by investment, any interest in the mineral in place, and (2) secured by legal relationship income derived from the extraction of the oil, to which he must look for a return of his capital. This basic principle, as applied in the *Southwest Exploration Co.* case, in *Burton-Sutton Oil Company*, and in *Palmer v. Bender* does not permit the conclusion that economic interest is a composite of indefinite and inexplicable vagaries, to be resolved by the weight accorded to a host of circumstances by the district judge. Even in the complicated situations involving oil leases, this Court never rested its determinations upon the purely legal reactions of the lower tribunals to the undisputed facts.

In the instant cases, the petitioners acquired the exclusive right to strip mine the reserved or leased areas.

They assumed all expenses and liabilities incident to discovery and production. They were not entitled to any compensation or reimbursement of expenses in the event they failed to discover and produce merchantable coal. And under the terms of contract between petitioners and Reading, the latter agreed to pay a stated price per ton for coal produced by petitioners. This constituted petitioners' sole source of income from production, and their sole return upon their investment.

These facts leave no room for discretionary decisions. The Court of Appeals disregarded the two fundamental rules for the statutory depletion deduction as declared by this Court, and gave decisive consideration to extraneous circumstances to reach its result.

As to the first of the two requirements specified by this Court, the Court of Appeals failed to recognize that the "investment" to which this Court referred in its decisions is synonymous with "economic interest." This is evident from *Burton-Sutton Oil Company v. Commissioner*, 328 U. S., at pages 29, 32, 34, wherein this Court pointed out that the requisite investment may be acquired through gaining a share in the control over extraction or the right of production of the mineral in place. Indeed, in *Commissioner v. Southwest Exploration Co.*, 350 U. S., at page 312, this Court expressly stated that no money need actually be invested in the deposit. Petitioners, as lessees, clearly had a capital investment in the mineral in place. The Court of Appeals failed to recognize that, since depletion depends upon production, such interest could not be affected by the fact that the interest might have been terminated.[1]

Further, the Court of Appeals, misconceived the second of the two rules specified by this Court insofar as it insisted that the petitioners should have shared the risk of the ultimate market. Petitioners were solely dependent upon

1. In the *Southwest Exploration Co.* case, the lower courts expressly noted the fact that the arrangements with the upland owners, to whom this Court allowed the depletion deduction, were terminable at any time. 220 F. 2d 58, 62 (9th Cir. 1955).

extraction for their return and they received only a stated price per ton for coal produced. This complies with all that is necessary for the depletion deduction under this Court's decisions.

Having met the requirements laid down by this Court, the petitioners were entitled to the depletion deduction. Only through ignoring the rules declared by this Court was the Court of Appeals able to reach a different result.

2. The Decision of the Court of Appeals Is in Conflict With the Decisions of the Court of Appeals for the Fourth Circuit.

The Fourth Circuit Court of Appeals has expressly held, in strip mining cases, that the existence of an option to terminate, and the fact that the strip miner's income was derived from the agreement of the owner to pay a stated price per ton of coal extracted and delivered, do not operate to deprive the strip miner of the depletion deduction. First, that Court determined that the significant fact was the extraction pursuant to an exclusive right during the existence of that right. Second, that Court regarded it as sufficient that the strip miner depended completely upon extraction for his income. Third, that Court did not hesitate to conclude that the strip miner had a capital interest in the mineral deposit. *Weirton Ice and Coal Co. v. Commissioner,* 231 F. 2d 531 (1956); *Commissioner v. Hamill Coal Corp.,* 239 F. 2d 347 (1956); and see also, *Commissioner v. Gregory Run Coal Co.,* 212 F. 2d 52 (1954), cert. denied 348 U. S. 828.

In each respect, the decision sought to be reviewed is directly in conflict with the decisions of the Fourth Circuit.[2] The Court of Appeals for the Third Circuit noted this itself:

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2. With respect to the fact that the strip miner has a contract right to receive a stated price per ton, the decision in the instant cases is also at variance with the prior decision of the Third Circuit Court of Appeals in *Commissioner v. Mammoth Coal Co.,* 229 F. 2d 535, 538 (1955), cert. denied 325 U. S. 824.

"there is more basis for argument here . . . that the bargain contemplated such extensive mining of the area as would warrant characterization of the stripper's status as involving an interest in the mineral in place. Indeed, certain recent decisions of the Court of Appeals for the Fourth Circuit suggest the reasonableness of such an analysis on facts not very different from those here." (Appendix B, *infra*, page 20; 255 F. 2d, at pages 600-601.)

As already indicated, the Third Circuit Court of Appeals attempted to justify its contrary conclusion on the ground that the problem was within the area of reasonable discretion on the part of the district judge. It is respectfully submitted that only legal conclusions are involved in these cases, and these are for the court of last resort. But even in this explanation, the Third Circuit is in conflict with the Fourth Circuit (as well as with this Court) since the Fourth Circuit, in each case, reversed the lower court.

Reference is made to the dissenting opinion of Judge Kalodner (Appendix D, *infra* page 26), wherein the conflict between the two circuits is fully demonstrated.

Petitioners urge that the determination of the Court of Appeals for the Fourth Circuit in the *Weirton* and *Hamill* cases and the dissent of Judge Kalodner in this case are correct and in accord with the basic requirements for the depletion deduction specified by this Court. The option to terminate does not affect the right or control over production unless and until it is exercised. Plainly, in the taxable years the petitioners had gross income from mining, and had an interest in the mineral in place. Depletion depends upon production, and not upon cost, or value, or life of the economic interest involved. The depletion deduction is measured by gross income; consequently, the petitioners' right thereto does not result in the reaping of tax benefits beyond the exercise of their mining rights. To allow depletion to petitioners is consistent with the Congressional

intent to benefit the discoverer-producer, so long as he produces. See Sen. Rep. No. 617, 65th Cong. 3d Sess., 1939-1 (Part 2) Cum. Bull. 122; H. R. Rep. No. 1, 69th Cong. 1st Sess., p. 6, 1939-1 (Part 2) Cum. Bull. 319; 67 Cong. Rec. 3561-78.

Similarly, since petitioners' income was dependent exclusively upon extraction, the Fourth Circuit was clearly correct in holding that there was no further requirement that they assume the fluctation of the market. Indeed, there is no apparent reason for holding that petitioners, whose risks in the project were already burdensome, should not protect themselves by taking advantage of an assured customer and price.

It is respectfully submitted that the two Circuits are in direct conflict, and that this conflict can be resolved only by this Court.

3. The Issues Presented Are Significant to the Development of the Revenue Laws and to the Mining Industry.

This Court has not yet applied the depletion provisions of the Internal Revenue laws to the coal strip mining industry. The problems of strip mining coal, and the relationship between owner and strip miner are unusual. The issues, however, will continue to arise, since the 1954 Code perpetuates the 1939 Code in this respect. 26 U. S. C. Sections 611 (a), 613.

The decision of the Court of Appeals in the instant cases adopts a new concept, i.e., the reasonable discretion of the district court in the first instance, which by its own terms permits different tax results upon similar facts. The danger of this approach lies in the utter lack of uniformity which it condones; both taxpayers and the Internal Revenue Service are deprived of proper guidance enabling prompt collection of the revenue and the determination of liability therefor.

It is urged that this Court has not regarded, and does not regard, the applicable criteria in this class of case to be too vague. The bromide, that each case depends upon

its own facts, as Judge Kalodner pointed out in his dissent, does not excuse the application of the principles clearly and concisely expressed by this Court.

It is urged that the Court of Appeals for the Third Circuit committed error which puts it in conflict with the Fourth Circuit and with this Court. The only remedy remaining is that which petitioners here seek.

CONCLUSION.

The Court of Appeals has, in this instance, declared a policy fundamentally different from that followed by this Court, and unsettles the entire area involved under the depletion statute. In addition, it has, in conflict with the Fourth Circuit, deprived petitioners of the depletion deduction, despite the fact that they have met all requirements hitherto pertaining, because (1) their interest in the mineral in place was terminable, (2) they did not assume the risk of market fluctuations, and (3) their equipment was suitable for other strip mining operations and subject to depreciation. These reasons are the result of confusion, which requires the clarifying deposition of this Court, for the benefit of the uniform administration of the revenue laws.

For these reasons, petitioners respectfully submit that their Petition for Writs of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

INTERNAL REVENUE CODE OF 1939.

SEC. 23. **Deductions from gross income.** In computing net income there shall be allowed as deductions:

* * *

(m) **Depletion.** In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. * * *

(n) **Basis for depreciation and depletion.** The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

(26 U. S. C., 1952 ed., Sec. 23.)

* * *

SEC. 114. **Basis for Depreciation and Depletion.**

* * *

(b) **Basis for Depletion.**

* * *

(4) [As amended by Sec. 145(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 124(a) and (c), Revenue Act of 1943, c. 63, 58 Stat. 21] **Percentage depletion for coal** * * *

(A) **In General.** The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income

from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *.

(B) **Definition of Gross Income From Property.** As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * *

(26 U. S. C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(m)-1. **Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements.**—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed an-

nual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

• • •

APPENDIX B.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,315
No. 12,317
No. 12,319

GEORGE HUSS,
Appellant in No. 12,315

RUSSELL HUSS,
Appellant in No. 12,317

WESLEY HUSS,
Appellant in No. 12,319

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued December 19, 1957

Before: BIGGS, *Chief Judge;* and GOODRICH and HASTIE, *Circuit Judges.*

OPINION OF THE COURT

(Filed March 27, 1958)

HASTIE, *Circuit Judge.*

These appeals, like those we have decided today in *Parsons v. Smith,* F.2d , challenge a district court

ruling that a contracting firm which extracted coal from the land of another by strip mining was not entitled to claim a percentage depletion allowance in computing its income from that mining operation. Therefore, we will not repeat such of our discussion in *Parsons v. Smith* as presents legal conceptions common to all cases of this type. However, the controversies involve different arrangements between different parties concerning different tracts. And circumstances peculiar to a particular stripping arrangement may be decisive for or against the claimed depletion deduction. Therefore it is necessary to consider separately and in some detail the facts upon which the stripper relies in this case.

The present contractor, a partnership which we shall call Huss, entered into a written agreement with the Philadelphia and Reading Coal and Iron Co., hereinafter called Reading, concerning the strip mining of certain coal lands owned by Reading. For this work Huss was to be paid an agreed dollar amount per ton of usable ore it should extract and deliver to a colliery designated by Reading. The agreed price was described in the contract as "full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work". The provisions of this contract which relate to compensation are certainly no more favorable to the taxpayers' depletion claim than were the rather similar provisions in the *Parsons* case. In neither case does anything agreed or done about compensation suggest that the stripper acquired an interest in the mineral in place.

On the other hand the facts relating to the duration of the stripping agreement in this case are somewhat different from those in the *Parsons* case. Huss continued to mine the contract area until the parties mutually agreed that additional stripping would not be profitable. In this sense Huss did mine the deposit to exhaustion. However, the stripping contract expressly provided that Reading

could cancel the agreement, terminating it unconditionally and without liability, on thirty days notice in writing. We are not told the reason for including this cancellation clause. We know only that it was part of the contract and that it was not invoked during the course of the mining operation under the contract.

In these circumstances there is more basis for argument here than there was in the *Parsons* case that the bargain contemplated such extensive mining of the area as would warrant characterization of the stripper's status as involving an interest in the mineral in place. Indeed, certain recent decisions of the Court of Appeals for the Fourth Circuit suggest the reasonableness of such an analysis on facts not very different from those here. See *Commissioner of Internal Revenue v. Hamill Coal Corp.*, 1956, 239 F.2d 347; *Weirton Ice & Coal Supply Co. v. Commissioner of Internal Revenue*, 1956, 231 F.2d 531. But to us the most that can be said for the stripper's position on the present record is that reasonable men can differ on the inferences they draw from the facts and in the relative values they attribute to various facts in determining the category in which the total situation belongs. Indeed, this contract did not give the stripper the privilege of mining all uncovered coal after notice of termination, which in the *Parsons* case was thought to strengthen the stripper's claim to an interest in the mineral in place. Certainly a reasonable trial judge could view the absolute right of termination on thirty days notice as more significant than the fact that this privilege was not exercised in the given case. And this in substance is what the trial judge did. We cannot find reversible error in this evaluation of the evidence in relation to the rather vague standard the courts must administer in these cases.

Finally, we note that Huss invested a considerably larger sum than did the plaintiffs in the *Parsons* case in drilling and earth moving equipment. At one time Huss committed about $500,000 worth of equipment to this job.

However, the district court found that, except for one item, all of this equipment had utility for stripping operations in general rather than special adaptation to this project. Nothing appears which distinguishes such expenditures from capital expenditures normally made by independent contractors who undertake large projects in such familiar fields as road building and general construction.

We are satisfied that the conclusion of the district court was consistent with the rational application of the legal standards stated in the statute and the implementing Treasury Regulations to the facts at hand. That is enough to require affirmance.

A separate issue is raised on this appeal with reference to so much of the judgment below as denied appellants any depletion allowance for strip mining prior to December 31, 1944 under certain other agreements called the "Stevens contracts". This ruling was explicitly based upon the trial court's conclusion that the taxpayers, who as plaintiffs below had the burden of proof, had failed to establish the existence prior to 1945 of such an agreement as would support a depletion allowance. We have examined the evidence on this branch of the case. It is not so clear and convincing as necessarily to persuade any reasonable trier of fact. We must, therefore, sustain the trial court's finding against the appellants on the facts.

The judgment will be affirmed.

APPENDIX C.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12315 (D.C. No. 14775)

GEORGE HUSS
Appellant

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: BIGGS, *Chief Judge* and GOODRICH and HASTIE, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12317 (D.C. 14776)

RUSSELL HUSS,
Appellant

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: BIGGS, *Chief Judge* and GOODRICH and HASTIE, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12319 (D.C. 14777)

WESLEY HUSS,
Appellant

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: BIGGS, *Chief Judge* and GOODRICH and HASTIE, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF
Clerk

March 27, 1958

APPENDIX D.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,315
No. 12,317
No. 12,319

GEORGE HUSS,
Appellant in No. 12,315
RUSSELL HUSS,
Appellant in No. 12,317
WESLEY HUSS,
Appellant in No. 12,319

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA.

SUR PETITION FOR REHEARING

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

OPINION OF THE COURT

(Filed May 29, 1958)

PER CURIAM:

The petition for rehearing considered, we adhere to our view that the record affords adequate basis for the con-

clusion of the trial court that the stripper did not have a depletable interest in the mineral in place. It is strongly urged in the present petition that decisions of the Court of Appeals for the Fourth Circuit, cited and discussed in our opinion on this appeal, reach a contrary result on very similar facts. We are not sure what that Court of Appeals would do in reviewing a decision against the stripper on the facts of our case. But regardless of that, we are still persuaded that an affirmance is proper.

The petition will be denied.

KALODNER, *Circuit Judge*, dissenting

I would grant the petition for rehearing. Further, on rehearing I would reverse the judgment of the district court on the principal issue involved—the existence of an economic interest.

The Supreme Court has charted the course and the law in cases of this type. Only recently it stated, firmly and concisely, that a taxpayer is entitled to the depletion deduction "where he has: (1) 'acquired, by investment, any interest in the oil in place', and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital'". Commissioner v. Southwest Exploration Co., 350 U. S. 308, 314 (1956).

"These two factors usually considered together", said the Supreme Court in the Southwest Exploration case, "constitute the requirement of 'an economic interest.'"

Nothing was said by the Supreme Court in that case on the score as to the impact of a right of termination of a contract creating an economic interest on the existence of that interest in the first place. Nor has the Supreme Court said so in any other case. We did not consider nor did we pass upon this question in Commissioner v. Mammoth Coal, 229 F.2d 255 (1955). Nor has any other appellate court done so except the Fourth Circuit. That Circuit, however, has explicitly ruled that a right of termination does not destroy an economic interest which existed prior to its exercise. It

did so in two cases: Weirton Ice and Coal Supply Co. v. Commissioner, 231 F.2d 531, 533 (1956) and Commissioner v. Hamill Coal Corp., 239 F.2d 347 (1956).

In Weirton it was said (p. 535):

"It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all the taxable years."

In Hamill, the contract (entered into in 1944) was to continue for one year and from year to year thereafter with the right of either party to terminate it at any time upon 90 days' written notice. The contract was terminated in 1947 by mutual agreement "after Daniel [the stripper] had removed substantially all the coal with an overburden of less than 40 feet." (p. 349).

In Weirton the decision does not disclose when mining operation ceased or whether the stripper ever mined to exhaustion. In Hamill, however, the record discloses that subsequent to termination the owner of the mine actually mined some 90,000 tons of coal.

In the instant case it is undisputed that the stripper (taxpayers) mined to exhaustion and that the contracts were terminated by mutual agreement after such exhaustion so that the factual situation here is much stronger than in either Weirton or Hamill.

I agree with the view of the Fourth Circuit that the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists. The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right.

It is not necessary, however, that I go as far along the course stated in the decision of the instant case. The record here discloses that the termination clause was included in the contract as a precaution on the part of the owner to protect itself from possible difficulties with an incompetent stripper.[1] It may be noted parenthetically that in the opinion sought to be reconsidered it was erroneously stated "We are not told the reason for including this cancellation clause."

Assuredly, prior to the exercise of the termination clause, taxpayers here "had an economic interest in the oil [coal] in place through its [their] control over extraction." Burton-Sutton Oil Co., Inc. v. Commissioner, 328 U.S. 25, 34 (1946). That control, moreover, actually existed, as already said, until the property was mined to exhaustion. Further, as stated in Burton-Sutton Oil Co. "Depletion depends only upon production".

It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312.

There is no room for doubt that the taxpayers had the requisite control over production, for under the contracts, the Coal Company gave to taxpayers the exclusive right to mine all of the merchantable coal in place in the leased area. That such right might have been brought to an end does not affect the present fact that the economic interest existed.

There is also no room for doubt that the taxpayers depended solely upon production for their return, since they received only the agreed price per ton for coal produced and delivered. Indeed, they bore all risks of mining, including,

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1. Russell Huss testified (p. 60 N. T.) that the termination clause "was put in there in a form contract so as if they got hold of a contractor who was not reputable, who wouldn't live up to the contract, they could put him off the property without court action."

but not limited to, the finding and production of commercial quality coal in such quantities necessary to make operation profitable.

Until now, every appellate decision in this type of case, including our own decision in Commissioner v. Mammoth Coal Co., supra, has held that there is no requirement that the stripper must assume the risks of the ultimate market. To the extent that we now hold otherwise, we are in conflict with our decision in that case and with the decisions of the Fourth Circuit. We are also in conflict with the latest pronouncement of the Supreme Court, Commissioner v. Southwest Exploration Co., 350 U.S. at page 314, that the taxpayer must look solely to the extraction of the mineral for his return. That is what the taxpayers here had to do.

Although we said, in Commissioner v. Mammoth Coal Co., 229 F.2d at page 537, that "The facts in each case determine the result", I do not regard such declaration as an admission that the criteria to be applied are too vague to do so on other than the basis of "the reasonable man". To the facts must be applied statute and the specific rules pronounced by the Supreme Court in the interpretation of it. That is the teaching of Commissioner v. Southwest Exploration Co., supra.

I conclude, therefore, that the taxpayers during the taxable years involved had the requisite economic interest in the coal in place. This, to me, is the result required by the decisions of the Supreme Court, the Fourth Circuit, and this Court; and our present decision is inconsistent therewith.

Accordingly, I would grant rehearing and reverse the judgments of the district court.

APPENDIX E.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 12,315, 12,317 and 12,319

GEORGE HUSS,
Appellant in No. 12,315

RUSSELL HUSS,
Appellant in No. 12,317

WESLEY HUSS,
Appellant in No. 12,319

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA

SUR PETITION FOR REHEARING

Present: BIGGS, *Chief Judge;* and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges.*

After due consideration the petition for rehearing in the above-entitled cases is hereby denied.

Attest:

IDA O. CRESKOFF
Clerk

Dated: May 29, 1958

APPENDIX F.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,299
No. 12,300
No. 12,301

EMORY W. PARSONS and ERMA M. PARSONS,
Appellants in No. 12,299

HOWARD H. PARSONS and MARTHA PARSONS,
Appellants in No. 12,300

LAWRENCE H. PARSONS and GRACE E. PARSONS,
Appellants in No. 12,301

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued December 19, 1957

Before: BIGGS, *Chief Judge;* and GOODRICH and HASTIE, *Circuit Judges.*

OPINION OF THE COURT

(Filed March 27, 1958)

HASTIE, *Circuit Judge.*

These are appeals by taxpayers, who are partners in a business, from a judgment of the district court denying

their several claims for refunds of income taxes paid upon their respective distributable shares of certain partnership income derived from coal mining. The appellants can prevail only if the involvement of the partnership, hereinafter called Parsons, in a strip mining enterprise was such as to entitle the partners to deduct a depletion allowance, pursuant to Sections 23 (m) and 114 (b) of the Internal Revenue Code of 1939 as implemented by Treasury Regulation 111, § 29.23 (m)-1, 26 CODE FED. REG., 1949 ed., § 29.23 (m)-1, in computing partnership income from the mining operation. The problem presented is the often difficult, though familiar and recurring one of determining whether the person claiming a depletion allowance is "the owner of an economic interest in mineral deposits" within the meaning of Treasury Regulation 111, § 29.23 (m)-1.[1]

The almost simultaneous recent decisions of this court in *Commissioner of Internal Revenue v. Mammoth Coal Co.*, 1955, 299 F.2d 535, cert. denied 352 U.S. 824, and of the Court of Appeals for the Ninth Circuit in *Usibelli v. Commissioner of Internal Revenue*, 1955, 229 F.2d 539, have gone so thoroughly into this tax problem as it arises in the context of strip mining that we shall not elaborate again the basic concepts which are discussed in those cases. It is enough to repeat that the decisions make it clear that the economic interest in coal in place which will support a percentage depletion allowance for strip mining need not

1. ". . . .

"Under such provisions [Secs. 23 (m) and 114], the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. . . . An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production." 26 CODE FED. REG., 1949 ed., § 29.23 (m)-1.

amount to an estate or tenancy as understood in the law of real property. Yet, it must be something more than an independent contractor's normal right to the benefit of his bargain and the kind of "interest" which that right always gives him in the subject matter of the contract. In characterizing an asserted interest a court will be guided by the total picture revealed by the facts of the case at hand.

On this appeal the facts found by the district court are unchallenged. The Parsons firm is a contractor and over the years has engaged in road building, strip mining and the drilling of gas wells. Parsons derived the income involved in this case from strip mining conducted on land owned by the Rockhill Coal Co.

In preliminary negotiations Rockhill had proposed that Parsons undertake extensive stripping of the area in question under a detailed written contract and, to that end, Rockhill actually drafted a proposed contract. But Parsons refused to sign the agreement stating that it did not wish to be bound to a long term performance because, if opportunity should arise, it wished to return to road building. Accordingly, it was agreed that the partnership would proceed with stripping in the designated area under a terminable oral agreement. The essential provisions of that oral contract are set out in the trial findings.

The agreement defined the area to be mined but left the partnership free to work as it chose. The partnership understood that it was not obligated to mine the tract to exhaustion. Indeed, although operations under the oral agreement were conducted from time to time over an eight year period, the tract still contained much strippable coal when Parsons terminated its operations. Some of this coal was later mined by another contractor. Moreover, it was mutually understood from the beginning, in the light of the already mentioned desire of the partnership to be free to change from stripping to road building on short notice, that either party could terminate the oral agreement on ten

days notice. In this connection it was understood that after notice of termination by the landowner the partnership would still be privileged to remove and the landowner obligated to accept usable coal from which the partnership had actually removed the overburden—this constituting the major part of the stripping operation—before the notice was received.

It was agreed that the partnership should deliver the coal it mined to Rockhill's railroad cars and to no one else. In practice any coal which Rockhill rejected as unsuitable for its purposes was left in the pits as unsalable. The parties agreed in advance upon a stipulated price per ton which Rockhill was to pay Parsons for usable coal. This price was not geared to and did not vary with the market price of coal. However, the price could be and on occasion was altered to reflect increased costs of production.

Parsons made a considerable investment in movable equipment used in the Rockhill stripping operation. Early in the taxable period the partnership committed to this job its own equipment valued at some $210,000. At the same time it was using about $130,000 worth of Rockhill equipment under a rental agreement with the landowner. As the work progressed the partnership rented an increasing amount of Rockhill equipment and used less of its own. There is no indication that the partnership equipment had utility only for this job or was specially adapted to it.

We are satisfied that what the parties agreed and what they did disclose the partnership acting only as an ordinary independent contractor in mining the Rockhill tract. First, the matter of compensation was handled as in an ordinary contract job. The partnership had no freedom to sell or dispose of the coal to its own account. It was entitled only to an agreed price from the owner of the mining property. And since that price did not fluctuate with the market, there is nothing about the scheme of payment to indicate any interest of the contractor in the mineral. If we ask how this arrangement for payment to the

partnership for its work differed from the normal payment to an independent contractor for accomplishing an agreed result, it is immediately apparent that there is no significant difference.

The other important factor on this record is the agreed duration of the enterprise. Here it is noteworthy that the partnership did not enter the job with any understanding that it would mine the tract to exhaustion, and that it did not in fact do so. Rather, it was concerned from the beginning to remain free to discontinue stripping at any time. The terminability of the agreement on short notice was an essential and significant part of the bargain, not a mere formality inserted by some cautious draftsman. The logical conclusion from all of this is that the partnership contemplated and bargained for no economic interest in the mineral it agreed to extract beyond the independent contractor's normal concern with any subject matter with which he is to work for an agreed price. True, the ten day notice could not be used to deprive Parsons of compensation for work it already had done in removing the overburden from particular coal. But this special limited right to complete work already far advanced does not destroy the character of the contract as one deliberately made terminable on very short notice.

The cases support this view of the matter. While the courts characteristically look at the entire context in deciding whether mining contractors have depletable interests in the mineral in place, the stripper usually bases his claim upon one or both of the factors discussed above. In some circumstances the stripper's right to mine the deposit to exhaustion, or even for a rather considerable period without particular reference to exhaustion, is stressed. See *Commissioner of Internal Revenue v. Mammoth Coal Co., supra*; *Stilwell v. United States*, 4th Cir., 1957, 250 F.2d 736; *Winfield Mining & Contracting Co.*, 1954, 13 TCM 571; *James Ruston*, 1952, 19 T.C. 284; *cf.* G.C.M. 26290, 1950-1 CUM. BULL. 42. In others the fact that the stripper's in-

come from the mining operation varies in accordance with the market price of the mineral makes his claim of depletable interest persuasive. See *Commissioner of Internal Revenue v. Gregory Run Coal Co.*, 4th Cir. 1954, 212 F.2d 52, *cert. denied*, 348 U.S. 828 (Vincent-Swaney contract); *Virginia B. Coal Co.*, 1956, 25 T.C. 899; *Paul E. Barry, Inc.*, 1955, 14 TCM 37; *Winfield Mining & Contracting Co., supra*; *James Ruston, supra.* But see *C. A. Hughes & Co.*, 1955, 14 TCM 172. But unless some such special circumstance appears, differentiating the arrangement from the ordinary contract job, there is analytically no basis upon which the stripper, who has no conventional property in the mineral, can claim a depletable interest therein.

Appellants attach much significance to recent borderline cases in which the Court of Appeals for the Fourth Circuit has found that contractors engaged in strip mining on land of others were entitled to depletion allowances. See *Stilwell v. United States, supra*; *Commissioner of Internal Revenue v. Gregory Run Coal Co. supra*; *Weirton Ice & Coal Supply Co. v. Commissioner of Internal Revenue*, 4th Cir. 1956, 231 F.2d 531; *Commissioner of Internal Revenue v. Hamill Coal Corp.*, 4th Cir. 1956, 239 F.2d 347. That court has certainly gone as far as any other in recognizing depletable interests in strippers. But in the cited Fourth Circuit decisions we find repeated emphasis upon the court's factual conclusion that the real understanding of the parties was that the strip miners would be allowed to exhaust the mineral, or at least to continue stripping operations for a very substantial time. Only in one of the arrangements considered in *Commissioner of Internal Revenue v. Gregory Run Coal Co., supra*, does this factor seem to have been absent. And there the owner and the strip miner had formalized their relationship in an agreement terming the strip mining project "this joint adventure." How much weight the court accorded this indication of the way the parties themselves viewed their relationship, we do not know. Perhaps no more can be said than that distin-

guishing facts usually prevent reasoning by analogy from being very helpful in borderline cases. In any event, we think the reasoning of the Fourth Circuit cases requires the stripper to marshal more significant indicia of interest in the mineral than the present record will yield.

One other point deserves separate mention. In these mining cases the allowance of a percentage depletion deduction from gross income for tax purposes is premised on the conception that a tax free recovery of capital actually invested in a wasting mineral deposit is fair. See *Commissioner of Internal Revenue v. Southwest Exploration Co.*, 1956, 350 U.S. 308, 312. The commitment of capital as an investment in the exploitation of a given mineral deposit must be real and unequivocal. Otherwise, mining contractors, like contractors generally, must look to "receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working." See *Usibelli v. Commissioner of Internal Revenue*, *supra*, 229 F.2d at 541.

Here the only thing set up as a capital investment in the Rockhill coal deposits is Parsons' purchase of a considerable quantity of movable equipment, accompanied by the rental of other equipment from Rockhill. There has been no showing that this equipment was specially adapted to this job or that it would not be suitable thereafter for such other undertakings as constituted the normal and familiar business of this contractor. Thus, quite apart from considerations relating to compensation and the terminability of the contract, it is very doubtful whether investment in equipment of general utility in a contractor's business is the type of capital expenditure which can properly be found to constitute an investment in a particular mineral deposit which the contractor has undertaken to work.

For these reasons we agree with the district court that the tax refund claims in suit are not well founded.

The judgment will be affirmed.

OPINION OF THE COURT OF APPEALS ON PETITION FOR REHEARING.

Present: BIGGS, *Chief Judge*; and MARIS, GOODRICH, STALEY and HASTIE, *Circuit Judges*.

PER CURIAM:

This petition for rehearing raises no point of substance that has not already been considered and decided against the petitioner. Accordingly, the petition is denied.

KALODNER, *Circuit Judge*, dissenting.

I am of the opinion that a rehearing should be granted and the judgment of the district court reversed.

This result is required for the reasons I have given in my dissenting opinion in the Huss cases.

The taxpayers here, as in the Huss cases, were granted an exclusive right to remove all the merchantable coal in place in the reserved or leased area. They had a right of control over production of the mineral in place which gives rise to the economic interest necessary for the depletion allowance. Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 29, 32 (1946). All the coal involved was produced during the existence of this interest. The fact that such interest might have been brought to an end some day in the future is not a relevant consideration.

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IN THE

Supreme Court of the United States

October Term, 1958.

No. 305.

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF FOR PETITIONERS.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1958.

No. 305.

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS,
Petitioners,

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONERS.

OPINIONS BELOW.

The Findings of Fact (R. 27) and Opinion (R. 37) of the District Court for the Eastern District of Pennsylvania are reported at 150 F. Supp. 224.

The Opinion of the Court of Appeals for the Third Circuit (R. 67) is reported at 255 F. 2d 599.

The Opinion of the said Court on Petition for Rehearing (R. 81) is reported at 255 F. 2d 601.

JURISDICTION.

The judgments of the Court of Appeals for the Third Circuit were entered on March 27, 1958 (R. 70-72). A petition for rehearing, timely filed, was denied on May 29, 1958 (R. 85). A petition for writ of certiorari, filed on August 25, 1958, was granted on October 13, 1958 (R. 86).

The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

STATUTES AND REGULATIONS INVOLVED.

The statutes involved are Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939, as amended, 26 U. S. C. (1952 ed.) Sections 23(m) and 114(b)(4). The pertinent text thereof is printed in Appendix A, *infra*, pages 19-20.

The regulation involved is Treasury Regulation 111, 26 Code Fed. Regs. § 29.23(m)-1 (1949). It is printed in Appendix A, *infra*, page 21.

QUESTION PRESENTED.

Where Petitioners acquired by agreement from the landowner the exclusive right to strip mine all coal on the land, and Petitioners assumed all risk and expense involved in the discovery and production of marketable quality coal, which the landowner agreed to buy at a stated price per ton, are they entitled to the statutory depletion allowance with respect to gross receipts from the coal mined by them in the taxable years where the landowner had a power which it did not exercise, to terminate the interest of Petitioners?

STATEMENT OF THE CASE.

These cases come before this Court on writ of certiorari to the United States Court of Appeals for the Third Circuit to review decisions of that Court which affirmed judgments of the United States District Court for the Eastern District of Pennsylvania denying Petitioners' claims for refunds of income taxes paid with respect to the calendar years 1944 to 1947, inclusive.

Petitioners were partners engaged in mining Anthracite by the strip-mine method. During the years 1944 to 1947 they were engaged in strip-mining lands located in Schuylkill County, Pennsylvania, pursuant to written agreements with the landowner, Philadelphia & Reading Coal & Iron Co. (hereinafter called P. & R.). These agreements

referred to separate tracts of land and are designated P-22 (May 27, 1944), P-22B (February 23, 1945), P-29 (May 8, 1945), P-30 (July 16, 1945), P-32 (December 17, 1945), and P-35 (July 19, 1946). All of the agreements pertain to specific areas in the so-called Tower City Tract, except P-30 the subject of which was an area known as the Forestville Area, approximately ten or twelve miles from the Tower City Tract (R. 27-28).

The agreements were almost identical, differing only in that P-22 contained a different termination clause (Pl. Ex. 1, Article 23, R. 86, 98; Ex. A, Article 23, R. 128, 139-140, and see R. 37, footnote 7) and in that each agreement called for a different price per ton for delivered coal which P. & R. was to pay to Petitioners.

By the terms of these agreements, P. & R. reserved specific areas of previously mined land and granted to Petitioners the exclusive right to discover and produce all the coal which might be found therein. P. & R. assumed no responsibility for the discovery of coal and gave no guarantee of the quantity of coal in the stripping area. The only obligation of P. & R. was to pay a stated price for each ton of coal actually delivered to it. In fixing the stated price, market values of coal were taken into consideration (Finding of Fact No. 26, R. 33). On the other hand, Petitioners expressly assumed "all risk in connection with the prospecting, discovery and recovery of coal and the operation of the entire stripping project" (Article 5, R. 91-92, 133-134). Among other obligations, Petitioners agreed to provide and pay for materials, labor, tools, equipment, water, light, transportation and all other facilities necessary for the mining operations (Article 10, R. 94, 136); to pay all taxes, carry liability insurance (Article 25, R. 99, 140), and to obtain and pay for all permits required by public authority (Article 27, R. 100, 141).

Petitioners determined when and where to begin, and when and where to stop strip mining in any area. They also determined whether or not it would be profitable to

begin strip mining. If they determined that it would not have been economically feasible to mine, they were not entitled to reimbursement for prospecting costs (Finding of Fact No. 17, R. 31). They paid the men who did the work and also paid for all equipment, supplies and materials (Finding of Fact No. 18, R. 31). Petitioners built roads, constructed buildings and supply houses. They commenced stripping operations with equipment valued at about $100,000. and by the end of 1947 had increased their investment to about $500,000. Most of their equipment was usable only for strip mining (Findings of Fact Nos. 19-21, R. 31-32).

Petitioners were compelled to look exclusively for their return and profit to the price per ton which P. & R. agreed to pay for coal actually delivered (Finding of Fact No. 16, R. 31).

Upon commencing operations under the first agreement, P-22 (R. 86), Petitioners produced a small amount of tonnage after three weeks, but it was at least two months before they produced sufficient tonnage to compensate them and to return a small profit (Finding of Fact No. 23, R. 33, R. 16-17).

No contract was ever terminated unilaterally by P. & R. In every case, when Petitioners had determined that they had exhausted an area, and ceased strip mining, the contract was terminated by a written agreement between P. & R. and Petitioners (Finding of Fact No. 31, R. 35). Although the District Court found that no particular duration of time was specified in the strip-mining agreements (Finding of Fact No. 31, R. 35), the agreements specifically gave Petitioners the right to all the coal recoverable by stripping (See Contract P-22, Article 1, R. 90; P-22B, Article 1, R. 131).

The Petitioners, in view of the substantial commitments and investments involved, were concerned with the 30-day cancellation provisions of the form agreements, and were advised that such provisions were inserted to permit P. & R. to sever relationships with unsatisfactory strip miners

without the necessity of resorting to legal proceedings (R. 9-11).

The District Court held that Petitioners had no "economic interest" in the coal in place and were therefore not entitled to the statutory depletion allowance pursuant to Sections 23(m) and 114(b) of the Internal Revenue Code of 1939 (R. 47). On appeal, the Court of Appeals for the Third Circuit affirmed, although it evidently believed there was a reasonable basis for characterizing Petitioners' status as involving an interest in the mineral in place. The Court of Appeals concluded that the standard to be administered was too vague to permit it to reverse the District Court (R. 68-69).

On Petition for Rehearing, Petitioners pointed out that the Court of Appeals had erred in its statement as to the content of the record with respect to the purpose of the cancellation provision of the form P. & R. agreements (R. 72), a point the Court of Appeals deemed relevant and pertinent. Nevertheless, rehearing was denied, Judge Harry E. Kalodner dissenting (R. 82-85).

SUMMARY OF ARGUMENT.

Petitioners are entitled to share in the depletion allowance provided for by Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 to the extent of 5% of their gross income from coal mining operations undertaken pursuant to agreements with the landowner in the present case. It was the Petitioners who exercised control over the production of the coal and contributed the necessary capital outlays for the exploration, discovery and extraction of the coal, thereby incurring the risk of loss.

The depletion allowance was intended by Congress to encourage the very activities carried on by the Petitioners in the present case. Therefore, Petitioners fall within the class to whom the depletion deduction should be given.

This Court has held time and again that if a taxpayer acquires by investment *any* interest in the mineral in place and secures by any form of legal relationship income derived from the extraction of the mineral upon which the return of his capital is entirely dependent, then he qualifies for the depletion allowance.

The Petitioners herein have the requisite interest. Their agreements with the landowner conferred upon them the exclusive rights to mine the coal in the reserved areas. Since their reward for their operations lay solely in the extraction of the coal, which the landowner agreed to buy at a fixed price, they were completely dependent upon extraction of the coal for the return of and a profit upon their investment.

The concept of "investment" is synonymous with the concept of "interest". Both refer to rights over production of the mineral upon which income depends. Furthermore, Petitioners literally acquired their interest by investment through their commitment to devote their entire resources to the undertaking. And, in fact, Petitioners did make a vast capital outlay in the stripping project in discovering the coal, in preparing the land for extraction, and

in acquiring costly equipment for the actual mining of the coal. This "investment" was the consideration for which the landowner granted the Petitioners the production rights contained in the agreements.

Although the landowner could terminate the Petitioners' rights upon thirty days' notice, in fact it did not, and the contracts were terminated by mutual agreement of the parties only after the coal tracts were mined to exhaustion by Petitioners. Moreover, since depletion depends upon extraction and is calculated upon the gross income therefrom, the possiblity of termination is an irrelevant consideration. The depletion deduction results in no tax benefit to Petitioners other than that which they earned by extraction and sale of the coal.

Certainly, the fixed price arrangement does not militate against Petitioners' right to the depletion allowance, since such method of payment does not render the Petitioners independent of extraction for the return of their investment in the coal in place. The payment was based on current market conditions and both Petitioners and P. & R. bore the risk of future fluctuations of the market.

Petitioners undoubtedly have that economic interest which alone is the prerequisite to obtaining the depletion allowance. The decisions of the Courts below are in direct conflict with the rule as applied by this Court in *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308 (1956), and *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25 (1946).

ARGUMENT.

I. The Petitioners Are Entitled to the 5% Depletion Allowance on Their Gross Income Received as a Result of Their Mining Activities Herein.

Section 23(m) of the Internal Revenue Code of 1939 (*infra*, Appendix A, page 19) states that a reasonable allowance for depletion shall be allowed as a deduction in computing net income in the case of mines. In the case of leases, it is specifically provided that the deduction shall be equitably apportioned between the lessor and the lessee.

The issue presented for decision in this case is, therefore, whether the Petitioners are entitled to share in the depletion allowance, i.e., whether they are entitled to the depletion allowance with respect to gross income from their mining operations. If the Petitioners are so entitled, then the landowner must deduct the amounts paid to the Petitioners in determining its depletion allowance with respect to its gross income from the coal Petitioners mined. This is so because the aggregate of the deductions for percentage depletion taken by all parties sharing in the production and conversion into gross income of the coal cannot exceed 5% of the gross income from the property, i.e., gross income from mining.[1]

1. Section 114(b)(4) of the 1939 Code (*infra*, Appendix A, page 20), specifies that percentage depletion for coal mines shall be 5% of the gross income from the property during the taxable year, excluding an amount equal to rents or royalties paid or incurred by the taxpayer in respect of the property. "Gross income from the property" is defined as meaning gross income from mining, and "mining" is defined to include not merely extraction, but also ordinary treatment processes normally applied by "mine owners or operators" in order to obtain the commercially marketable mineral product.

A. The Depletion Allowance Is Granted to One, in the Position of Petitioners, Who Has an Economic Interest in the Mineral in Place.

The law of depletion requires an economic rather than a legal interest in the mineral in Place. *Commissioner v. Southwest Exploration Co.*, 350 U. S. 308, 316 (1956); *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599, 603 (1946). Title to, or ownership of, the mineral deposit is not necessary nor is the nature of the instrument creating the rights significant. And, even though under local law a taxpayer may not be regarded as having a legal interest in the mineral in place, he may nonetheless have acquired a depletable interest. *Burton-Sutton Oil Co. v. Commissioner*, 328 U. S. 25, 32-35 (1946); *Kirby Petroleum Co. v. Commissioner, supra; Burnet v. Harmel*, 287 U. S. 103 (1932); *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364 (1925).

This Court recently reiterated in *Commissioner v. Southwest Exploration Co., supra*, at 314, the holding of *Palmer v. Bender*, 287 U. S. 551, 557 (1933), that the requisite economic interest exists in every case in which the taxpayer has acquired, by investment, any interest in the mineral in place, and secures, by any form of legal relationship, income derived from the extraction of the mineral, to which he must look for a return of his capital.

What marks an economic interest in the mineral in place is the possibility of profit from the use of rights over production, dependent solely upon the extraction of the mineral and its conversion into gross income. *Commissioner v. Southwest Exploration Co., supra*, at 316; *Burton-Sutton Oil Co. v. Commissioner, supra*, at 34-35. Legal ownership may in any case exist in another, but where control over production exists, the person in whom it resides acquires an economic interest which represents his capital investment and is subject to depletion. *Palmer v. Bender, supra*, at 557; *Lynch v. Alworth-Stephens Co., supra*, at 370.

B. The Petitioners Had an Economic Interest in the Coal in Place by Virtue of Their Right to Extract the Mineral, Their Assumption of All Risks of Discovery and Production, and Their Complete Dependence Upon Extraction of the Mineral for Their Return.

In the case *sub judice*, the Petitioners acquired an exclusive right to all the coal recoverable by strip-mining from the areas specifically reserved to them. They assumed all risks of discovery and production. Indeed, as the agreements show on their face, Petitioners were engaged in salvage stripping in previously deep-mined areas, and the risk of finding and producing such amounts of commercial quality coal, as would render their commitments and expenditures economically feasible, was significantly increased. The Petitioners determined where and when to begin and where and when to stop mining. They actually mined to exhaustion all the areas involved, and the agreements were thereafter terminated only by the mutual assent of the Petitioners and P. & R. Moreover, Petitioners had no recourse to recover any of the expense of prospecting and mining except through the production of coal, which P. & R. agreed to buy at a specific, pre-determined price per ton.

Whether the agreements be characterized as leases or licenses is immaterial; their significance is that they gave Petitioners control over the extraction of the coal and thus created an interest in the coal in place in the Petitioners. And, since Petitioners were entitled to payment only for coal produced, it is obvious that they secured by legal relationship income derived from the extraction of the coal, to which they necessarily looked for a return of their capital.

The treatment of this subject in the Court of Appeals, however, demonstrates fundamental error; the Court saw in the requirement that an interest in the mineral be acquired by investment the necessity for "capital expenditure".

It is respectfully submitted that the term "investment", as used in the concepts related to percentage depletion, and as used in the *Kirby Petroleum Co., Burton-Sutton Oil Co.* and the *Southwest Exploration Co.* decisions, is synonymous with "economic interest." It cannot matter that the interest was acquired at a nominal price, or even that it was acquired by gift or devise. As stated in the *Burton-Sutton Oil Co.* decision, *supra*, 34:

> "The cost of that investment to the beneficiary of the depletion under Section 114(b)(3) is unimportant. * * * Through retention of certain rights to payments from oil or its proceeds in himself, each of these assignors of partial *exploitation rights* in oil lands has maintained a *capital investment* or *economic interest* in the oil or its proceeds." (Emphasis supplied.)

If the Petitioners here had assigned their rights over production to a third party, reserving to themselves a royalty on each ton of coal extracted, they would have been in the same position as the assignor whose right to percentage depletion was upheld by this Court in the *Burton-Sutton Oil Co.* case. Petitioners cannot lose their tax benefit because they chose to exercise their rights over production through extracting the coal themselves.

Furthermore, Petitioners literally acquired their interest by investment through their commitment to devote their entire resources to the undertaking. And, in fact, Petitioners did make a vast capital outlay in the stripping project in discovering the coal, in preparing the land for extraction, and in acquiring costly equipment for the actual mining of the coal. This "investment" was the consideration for which the landowner granted to the Petitioners the production rights contained in the agreements.

Accordingly, the only proper conclusion is that Petitioners did acquire, by investment, an interest in the mineral in place.

Until the decision in the instant case, the Courts of Appeals presented with the issue of the entitlement of a

strip miner to the depletion allowance have consistently held, in circumstances similar to those here, in his favor. *Commissioner v. Hamill Coal Corp.*, 239 F. 2d 347 (4th Cir. 1956); *Weirton Ice and Coal Co. v. Commissioner*, 231 F. 2d 531 (4th Cir. 1956); *Commissioner v. Mammoth Coal Co.*, 229 F. 2d 535 (3d Cir. 1955), *cert. denied*, 325 U. S. 824; *Stilwell v. United States*, 250 F. 2d 736 (4th Cir. 1957); *Commissioner v. Gregory Run Coal Co.*, 212 F. 2d 52 (4th Cir. 1954), *cert. denied*, 348 U. S. 828. *But cf., Usibelli v. Commissioner*, 229 F. 2d 539 (9th Cir. 1955).

C. Neither the Power of P. & R. to Terminate the Agreements Upon Thirty Days' Notice, Nor Its Obligation to Pay a Fixed Price Per Ton of Coal Delivered Prevented the Petitioners From Acquiring an Economic Interest in the Coal in Place.

1. *The Power of P. & R. to Terminate the Agreements Upon 30 Days' Notice Is Irrelevant to the Determination of Petitioners' Interest in the Coal in Place.*

Although the Court of Appeals thought that it was a reasonable conclusion on the facts of the case that the Petitioners had an interest in the mineral in place, it permitted the judgments of the District Court to stand. In the Court of Appeals' view, the appraisal of the significance of the power of termination was a matter of factual inference for the District Court.[2] In so holding, the Court of Appeals committed error, since the relationship of the power of termination to "economic interest" is a matter of law.

2. It should be noted that the Court of Appeals misapprehended the content of the record. As Judge Kalodner pointed out in his dissent to the denial of rehearing,

> "The record here discloses that the termination clause was included in the contract as a precaution on the part of the owner to protect itself from difficulties with an incompetent stripper. It may be noted parenthetically that in the opinion sought to be reconsidered it was erroneously stated 'We are not told the reason for including this cancellation clause.'" (255 F. 2d, at 602; R. 84)

The net effect of the holding of the Court of Appeals is to treat the Petitioners as though P. & R. had actually exercised its power of termination, as though the thirty day period had thereafter expired, and thus as though the right of Petitioners to extract the coal had been rendered non-existent. But the facts are just the contrary.

The power of termination was purely legal. Unless and until it had been exercised, it could not affect the Petitioners or their economic relationship to the coal in place.

We are here dealing with economic realities, not legal abstractions; we are concerned with facts, not with possibilities which did not occur. *Commissioner v. Southwest Exploration Co., supra,* at 315, 316. No contract was terminated unilaterally by P. & R., but the contracts were terminated only by the express written agreement of both P. & R. and Petitioners after Petitioners had, in their judgment, mined the coal to exhaustion. The value of the right of extraction which Petitioners enjoyed, notwithstanding the existence of a power of termination, is accurately reflected by their investment of $500,000. in mining equipment purchased for the operations, as well as by the capital outlay they made for the construction of roads, building, supplies and materials, and for the general financing of the mining operations.

The Court of Appeals cannot properly change the relationship of the parties. It cannot properly superimpose its judgment upon the parties, and treat as exercised, contractual powers which the parties did not choose to exercise, nor may it interpret those powers in a manner contrary to the parties' own interpretation as demonstrated by the actual facts.

As Judge Kalodner pointed out in his sharply defined dissent from the denial of the Petition for Rehearing, an unexercised power of termination does not negate the existence of an economic interest in the mineral in place. "That such right [to mine the coal] might have been brought to an end does not affect the present fact that

the economic interest existed." (255 F. 2d, p. 603; R. 84.) "The Commissioner and the courts must deal with a situation as it exists during the taxable year involved and not as it might exist in some future year because of the possible occurrence of an event through the exercise of a contractual right." (255 F. 2d, p. 602; R. 83.)

Judge Kalodner's view is fully and completely supported in this regard by the decisions of the Fourth Circuit. See *Commissioner v. Hamill Coal Corp., supra; Weirton Ice and Coal Supply Co. v. Commisssioner, supra.*[3]

2. *The Right of Petitioners to Receive a Stated Price Per Ton of Coal Is Consistent With Their Possession of an Interest in the Coal in Place.*

The Court of Appeals found nothing in the price arrangement between Petitioners and P. & R. to suggest that Petitioners acquired an interest in the coal in place. Precisely what the Court of Appeals was seeking does not appear.

It is not disputed that Petitioners were entitled to payment only for coal discovered, extracted and delivered to P. & R. It is plain, therefore, that they secured by legal relationship income derived from the extraction of the coal, to which source alone they looked for the return of their capital. No more is required. *Commissioner v. Southwest Exploration Co., supra,* at 314.

The complete dependence of Petitioners upon extraction of the coal for their return is not lessened because

3. In the *Weirton* case, the Court offered this terse comment on the right of termination:

> "It is of no moment that the owner of the mineral, as in other cases in which the right of the extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all the taxable years." (231 F. 2d, p. 535)

The Internal Revenue Service, for reasons unknown, takes the position that a stripper is not entitled to the depletion allowance if his contract is terminable upon less than one year's notice. G. C. M. 26290, 1950-1, Cum. Bull. 42.

they did not contract to receive a percentage of the income from the ultimate sale of the coal by P. & R.

It was early determined that nothing in the tax statute precludes Petitioners from disposing of the coal extracted by them at a fixed price. *Eastern Coal Corp. v. Yoke*, 67 F. Supp. 166 (N. D. W. Va., 1946). The Court of Appeals for the Fourth Circuit, in *Hamill, Weirton, Stilwell,* and *Gregory Run,* as well as the Court of Appeals for the Third Circuit in *Mammoth,* fully agreed.

Petitioners chose to make a stable price bargain under existing market conditions, thereby sacrificing the benefit of any market increase in order to protect themselves against any market decrease. They substituted one risk for another. Certainly this cannot operate to deprive them of their right to the depletion allowance.[4]

II. The Petitioners' Role in the Production of the Coal Brings Them Within the Class Intended to Enjoy the Benefit of the Percentage Depletion Allowance.

The depletion deduction was not given solely to permit recoupment of a capital investment. As this Court said in *Commissioner v. Southwest Exploration Co., supra,* at 313:

> "The present allowance, however, bears little relationship to the capital investment, and the taxpayer is not limited to a recoupment of his original investment. The allowance continues so long as minerals are extracted and even though no money was actually invested in the deposit. The depletion allowance in the Internal Revenue Code of 1939 is solely a matter of legislative grace * * *."

The depletion allowance was provided to stimulate prospecting, exploration and production of minerals. Sen.

4. The fixed rates of payment here involved are analogous to the flat royalty payments sanctioned in *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599 (1926); *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364 (1925).

Rep. No. 617, 65th Cong., 3d Sess., 1939-1 (Part 2) Cum. Bull. 121-122; H. R. Rep. No. 1, p. 6, 69th Cong., 1st Sess., 1939-1 (Part 2) Cum. Bull. 319; Statement of Senator Reed, 67th Cong. Rec. 3561-3578; Statement of Senator Gore, 78th Cong. Rec. 6182-6183. These records leave no room for doubt that it was the purpose of Congress to encourage taxpayers in the situation of Petitioners and to reward them for the assumption of the inherent risks of discovery and extraction. The Code of 1939 not only simplified the determination of the allowance, but reflected the further need to promote mining by allowing percentage depletion without regard to whether the mine represented a new discovery. See 4 Mertens' Law of Federal Income Taxation, § 24.31a (1954).

It is self evident that P. & R. was primarily interested in the handling of coal following its production. A casual reading of the form agreements which it prepared conclusively demonstrates that it desired to be relieved of the substantial risk of discovering commercial quality coal in adequate quantities to render economically justifiable the tremendous investment required for the salvage mining operation. Indeed, it will be seen from an inspection of these forms of agreements which P. & R. prepared, that P. & R. securely tied that risk to the Petitioners.

The Petitioners manifestly played the major and integral role in the actual production of the coal. They brought to the mining operation the benefit of their experience and the commitment of their resources. Their equipment, usable only for strip mining, constituted a substantial capital investment. Petitioners contributed the capital necessary to prospect for and discover the coal and to extract it from the ground, to build roads and construct buildings. All of these expenditures increased the risk undertaken, since the Petitioners looked solely to production for the return of their investment.

It is respectfully submitted that the Petitioners come within the purview of the applicable statute, and that they

are beneficiaries of the legislative grace by natural qualification, since the functions performed by them are precisely those sought to be encouraged and rewarded by Congress through the depletion deduction.

CONCLUSION.

Petitioners have satisfied every requirement for the depletion allowance, *Commissioner v. Southwest Exploration Co., supra*, and therefore the judgments of the Court of Appeals should be reversed.

Respectfully submitted,

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LEON H. KLINE,
Attorneys for Petitioners.

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APPENDIX A.

Pertinent sections of the Internal Revenue Code of 1939 provide:

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

* * *

(m) Depletion. In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. * * *

(n) Basis for depreciation and depletion. The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

(53 Stat. 12, 14, 26 U. S. C., 1952 ed., Sec. 23.)

* * *

Sec. 114. Basis for Depreciation and Depletion.

* * *

(b) Basis for Depletion.

* * *

(4) [As amended by Sec. 145(a), Revenue Act of 1942, c. 619, 56 Stat. 840, and Sec. 124(a-c), Revenue Act of 1943, c. 63, 58 Stat. 44, 45 Percentage depletion for coal * * *

(A) In General. The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *.

(B) Definition of Gross Income From Property. As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. * * * The term "ordinary treatment processes" as used herein shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * * *

(53 Stat. 45, 26 U. S. C. 1952 ed., Sec. 114.)

Treasury Regulation 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23 (m)-1. Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements. Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

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MAR 2
JAMES R. BROW

IN THE

Supreme Court of the United States

October Term, 1958.

No. 305.

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS,
Petitioners,

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

REPLY BRIEF FOR PETITIONERS.

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THE CONCEPT OF "ECONOMIC ADVANTAGE" HAS NO APPLICATION TO THIS CASE; THE ECONOMIC INTEREST OF THE PETITIONERS IS CLEAR.

The Internal Revenue Code of 1939, whose provisions were in effect during the years for which the Petitioners seek tax deductions, expressly grants a taxpayer an allowance for depletion "in the case of coal mines, 5 per centum . . . . of the gross income from the property during the taxable year. . . . ." (53 Stat. 45, 26 U. S. C. 1952 Ed., § 114(b)(4)(A)).

And "gross income from the property" is defined as "the gross income *from mining*. The term 'mining' as used herein shall be considered to include not merely the *extraction of the ores or minerals from the ground* but also the ordinary treatment processes normally applied by mine owners *or operators* in order to obtain the commercially marketable mineral product or products." (53 Stat. 45, 26 U. S. C. 1952 Ed., § 114(b)(4)(B)). (Emphasis supplied.)

Beyond peradventure or doubt, the income of the petitioners came from and was entirely dependent upon one source: their mining or extraction of minerals from the ground. Their income was, therefore, "gross income from mining" within the plain language of the Code. Further, Petitioners' complete and exclusive control over the production of the coal conferred upon them the requisite interest in the mineral in place. *Burton-Sutton Oil Co. Inc. v. Commissioner*, 328 U. S. 25, 34 (1946). Thus, they have by natural qualification that "economic interest" which entitles them to the depletion allowance.

It is no answer to the case made out for the Petitioners to suggest, as respondent does, that the taxpayers were not entrepreneurs engaged in mining but employees rendering services under an employment contract. For purposes of entitlement to the depletion allowance, Petitioners' control of production contradicts this contention, and, for any purpose this theory is destroyed by the undisputed facts appearing in the record.

It was the Petitioners who alone decided when, where and how much to mine (R. 12; 31). It was the Petitioners who built the roads and the necessary buildings, and who invested over $500,000 in mining equipment (R. 31-32). It was the Petitioners who obtained all necessary mining permits (Ex. P. 1, R. 100; Ex. A, R. 141), who paid the appropriate taxes (Ex. P. 1, R. 99; Ex. A, R. 140), and who in fact, producing over 50,000 tons of coal a month (R. 14), mined the tracts to exhaustion (R. 35).

Certainly, in view of the Petitioners' negotiations with the United Mine Workers of America with respect to the terms and conditions of employment of the individual workers, the appellation of "employees" is singularly inappropriate (R. 7-9). By virtue of their exercise of complete control over production, their assumption of all risks in connection with the extraction of the coal and their independence in determining the nature and scope of their operations, Petitioners were entrepreneurs in the most literal sense of the word.

Equally, it is no answer to the case made out for Petitioners to suggest, as the Respondent does, that because the Petitioners' operations were pursuant to a writing executed by the parties, which purported to give the landowner power to terminate the Petitioners' interest in the coal on 30 days' notice, that such interest in the mineral never existed. But the basic error in the Respondent's argument is disclosed by the record itself; the power of termination was not, and was never intended to be, applicable to the Petitioners.

As Russell Huss testified, the Petitioners were much concerned about the termination clause contained in the contract prepared by the landowner. To use his words, "I didn't feel I wanted to move equipment on to a job and spend a certain amount of dollars moving it and find out after I had been there I would be put off in 30 days where I would not ever have a chance to get back the money I was investing" (R. 18).

Quite naturally he did not wish to expend funds and undertake obligations under such an apparent state of insecurity. However, representatives of the landowner assured him that the "provision was put in there in a form contract so as if they got hold of a contractor who was not reputable, they could put him off the property without court action" (R. 10).

The inescapable inference from this undisputed testimony is that the Petitioners, being reputable contractors, were not to be subject to unilateral cancellation by the landowner on thirty days notice. In fact, the intention of the parties was confirmed by their actions; in not a single instance did the landowner unilaterally terminate an agreement with the Petitioners (R. 11; 35). Each of the six contracts entered into with respect to the landowner's six coal tracts was terminated by mutual agreement (R. 35). Had the power to terminate been intended to apply to the Petitioners, there would have been no need whatsoever for the landowner to obtain Petitioners' consent to termination, especially when the coal tracts covered by the agreements had been mined to exhaustion (R. 35). The interpretation of these contracts by the parties themselves, as manifested in their conduct, is controlling.

Finally, it is no answer to the case made out for the Petitioners to suggest, as the Respondent does, that the interest of the Petitioners in the coal was "a mere economic advantage derived from production".

The concept of economic advantage was developed and applied by this Court some twenty years ago in the trilogy of *Helvering v. Bankline Oil Co.*, 303 U. S. 362 (1938); *Helvering v. O'Donnell*, 303 U. S. 370 (1938) and *Helvering v. Elbe Oil Land Co.*, 303 U. S. 372 (1938), to describe the interest of taxpayers who were denied the depletion allowance although their incomes were connected with the production of a mineral. In none of these cases did the taxpayer, a purchaser of gas (*Bankline*), a seller of stock in a corporation owning oil leases (*O'Donnell*), and a seller of oil land (*Elbe*), either produce, or possess a measure of

control over production of, the mineral. Whatever interests they possessed, therefore, were not interests in the mineral in place, and whatever incomes were obtained were not incomes from production of the mineral.

CONCLUSION.

The economic interest of the Petitioners is clear; the concept of "economic advantage" has no application to this case and therefore the judgments of the Court of Appeals should be reversed.

Respectfully submitted,

DAVID BERGER,
LEON H. KLINE,
Attorneys for Petitioners.

Of Counsel:

BERGER, STEIN AND KLINE.

SUPREME COURT OF THE UNITED STATES

Nos. 218 AND 305.—OCTOBER TERM, 1958.

Emory W. Parsons, Erma M. Parsons, Howard H. Parsons, et al, Petitioners,

218 v.

Francis R. Smith, Former Collector of Internal Revenue for the First District of Pennsylvania.

George Huss, Russell Huss and Wesley Huss, Retitioners,

305 v.

Francis R. Smith, Former Collector of Internal Revenue for the First District of Pennsylvania.

On Writs of Certiorari to the United States Court of Appeals for the Third Circuit.

[April 6, 1959.]

MR. JUSTICE WHITTAKER delivered the opinion of the Court.

These tax refund cases present the question whether petitioners, Parsons in No. 218 and Huss in No. 305, are entitled to an allowance for depletion on amounts received by them under contracts with the owners of coal-bearing lands for the strip mining of coal from those lands and the delivery of it to the landowners. The cases were heard by the same courts below. The District Court ruled that petitioners had no depletable interest in the coal in place and rendered judgment for the respondent—collector in each case. The Court of Appeals affirmed both judgments. 255 F. 2d 595, 599. Because of an asserted conflict with the principles applicable under the decisions of this Court, we granted certiorari in both cases. 358 U. S. 418.

The pertinent facts in each case were found by the District Court and are not challenged here. In substance, they are as follows:

PARSONS, No. 218. Petitioners were members of a partnership ("Parsons") which, until the transactions involved here, was primarily engaged in road building. Rockhill Coal Co. ("Rockhill") owned bituminous coal-bearing lands in Pennsylvania. Much of the coal was located relatively near the surface and was therefore removable by the strip mining process.[1] In 1942 Parsons expressed a desire to strip mine coal from Rockhill's lands, but it refused to sign the written contract offered because the firm did not wish to be bound by a contract "which would take a long time, since, if an opportunity opened up, [it] wanted to go back to road building." It was then agreed that Parsons would, and it did, proceed under an oral agreement. Under that agreement Parsons was to strip mine coal from such sites and seams, within a generally described area of Rockhill's lands, as were designated by Rockhill. Parsons was to furnish at its own expense all of the equipment, facilities and labor which it thought necessary to strip mine and deliver the coal to Rockhill's cars at a fixed point. For each ton of coal so mined and delivered Rockhill was to pay Parsons a stated amount of money.[2] Parsons was not authorized to keep or sell any of the coal but was required to deliver all that was mined to Rockhill. The agreement was not for a definite term, nor did it obligate Parsons to mine the tract to exhaustion, but, to the contrary, it was agreed that

[1] Strip mining is done from the surface of the earth. In general, it is performed by stripping off the earth, known as overburden, which lies over the coal and then removing the coal so uncovered.

[2] It was contemplated by the parties that in the event of an increase in the union labor wage scale the amount per ton to be paid to Parsons would be increased and on several occasions it was increased to cover higher costs for both labor and material used in the work.

"if Parsons or Rockhill wanted to quit, all that was necessary to terminate the arrangement was the giving of a ten-day notice." However, if Rockhill thus canceled the agreement and if "Parsons had previously gone to the expense of removing the overburden (thereby performing the heavy part of the work, as well as meeting wages and expenses in so doing), then Parsons would have the privilege of taking out the coal [so uncovered] and of being paid for it [even though] this took more than ten days." Operations continued under the agreement without notice of termination until August 1, 1950, when Parsons gave Rockhill notice that it would "quit" the work on September 1, 1950, and it ceased these operations on or near that date. Large amounts of strippable coal still remained on the tract and strip mining thereon was continued by another contractor. Parsons' investment in equipment used in the work ran from a low in 1943 of $60,000 to a high in 1947 of $250,000. The equipment was movable and there is no evidence that it was not usable elsewhere or for other purposes.

HUSS, No. 305. Petitioners were members of a partnership ("Huss") engaged in the business of strip mining coal. Philadelphia and Reading Coal & Iron Co. ("Reading") owned anthracite coal-bearing lands in Schuylkill County, Pennsylvania. Much of the coal was so located that it could be removed by strip mining. In 1944 Reading and Huss entered into a written contract [3] under which Huss undertook to strip mine the coal from such areas, within a generally described tract of Reading's land, as might be designated by Reading and that was not lying deeper than a prescribed distance from

[3] During the tax years involved, which were 1944 to 1947, other like contracts were entered into by the parties, but they were all identical, except for areas covered and prices per ton to be paid to Huss, and it will therefore be unnecessary to treat with them individually.

the surface. Huss was to furnish at its own expense all of the equipment, facilities and labor necessary to mine and deliver the coal to Reading's colliery. For each ton of coal so mined and delivered Reading was to pay Huss a stated sum.[4] That sum was agreed to be in "full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work." Huss was not authorized to keep or sell any of the coal. The contract was expressly terminable by Reading at any time upon 30 days' written notice "without specifying any reason therefor" and without liability for "any loss of anticipated profits or any other damages whatever." This right of termination was not exercised. Operations continued under the contract until July 1947, by which time Huss had mined most of the strippable coal on the lands covered by the contract that lay within the stipulated distance from the surface, and the contract was then canceled by mutual agreement. Huss' investment in equipment used in the work ran from a low in 1944 of $100,000 to a high in 1947 of $500,000. All of the equipment was movable and usable elsewhere in strip mining and some of it was usable for other purposes.

Whether a deduction from gross income shall be permitted for depletion of mineral deposits, or any interest therein, is entirely a matter of grace.[5] We therefore must look, first, to the provisions and purposes of the statutes and to the decisions construing them to see what interests are permitted a deduction for depletion, and, next, to the

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[4] The contract provided however that in the event of an increase in the union labor wage scale the amount per ton to be paid to Huss would be, and on several occasions during the operation it was, increased sufficiently to cover increased labor costs.

[5] *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366; *Anderson* v. *Helvering*, 310 U. S. 404, 408; *Commissioner* v. *Southwest Exploration Co.*, 350 U. S. 308, 312.

contracts involved to see whether they gave to petitioners such an interest.

The applicable statutes are §§ 23 (m) and 114 (b) (4) (A) of the Internal Revenue Code of 1939, 26 U. S. C. (1952 ed.) § 23 (m) and 26 U. S. C. (1946 ed.) § 114 (b) (4) (A). Section 23 (m) directs that a reasonable allowance for depletion shall be made "in the case of mines, . . . according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary," and that "[i]n the case of leases the deductions shall be equitably apportioned between the lessor and lessee." And § 114(b) (4) (A) provides that the allowance shall be, "in the case of coal mines, 5 percentum . . . of the gross income from [mining][6] the property during the taxable year, excluding . . . any rents or royalties paid or incurred by the taxpayer in respect of the property."

The purpose of the deduction for depletion is plain and has been many times declared by this Court. "[It] is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366. And see *United States* v. *Ludley*, 274 U. S. 295, 302; *Helvering* v. *Elbe Oil Land Development Co.*, 303 U. S. 372, 375; *Anderson* v. *Helvering*, 310 U. S. 404, 408; *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599, 603. "[The depletion] exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration*

[6] Section 114 (b) (4) (B) provided that "the term 'gross income from the property' means the gross income from mining." 26 U. S. C. (1946 ed.) § 114 (b) (4) (B).

Co., 350 U. S. 308, 312. Save for its application only to gross income from mineral deposits and standing timber, the purpose of "the deduction for depletion does not differ from the deduction for depreciation." *United States* v. *Ludley*, 274 U. S., at 303. In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset.

Although the sentence in § 23 (m) that "In the case of leases the deductions shall be equitably apportioned between the lessor and lessee" presupposes "that the deduction may be allowed in other cases" (*Palmer* v. *Bender*, 287 U. S. 551, 557), the statute "must be read in the light of the requirement of apportionment of a single depletion allowance" (*Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312, 321), for two or more persons "cannot be entitled to depletion on the same income" (*Commissioner* v. *Southwest Exploration Co.*, 350 U. S. 308, 309). It follows that if petitioners are entitled to a depletion allowance on the amounts earned under their contracts, the amounts allowable to the landowners for the depletion of their coal deposits would be correspondingly reduced.

Dealing specifically with the problem of what interests in mineral deposits were permitted a deduction for depletion under the practically identical predecessors of §§ 23 (m) and 114, this Court said in *Palmer* v. *Bender*, 287 U. S. 551, 557: "The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." The Court further said that the deduction is not "dependent upon the particular legal form of the taxpayer's interest in the property to be depleted, [and that] [i]t is enough if . . .

he has retained a right to share in the oil produced. If so he has an *economic interest* in the oil, in place, which is depleted by production." [7] *Ibid.* (Emphasis added.) The Court went on to hold that lessees of oil producing properties, by reserving from an assignment a royalty of "one-eighth of all the oil produced and saved," retained

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[7] The principles declared in the *Palmer* case have been recognized and applied by every subsequent decision of this Court that has treated with the subject.

Helvering v. *Bankline Oil Co.*, 303 U. S. 362, 367, literally adopted the language of the *Palmer* case upon the point.

In *Helvering* v. *O'Donnell*, 303 U. S. 370, 371, it was said: "The question is whether respondent had an interest, that is, a capital investment, in the oil and gas in place . . . . *Palmer* v. *Bender*, 287 U. S. 551, 557; *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312, 321; *Thomas* v. *Perkins*, 301 U. S. 655, 661; *Helvering* v. *Bankline Oil Co.*, *supra*."

Helvering v. *Elbe Oil Land Development Co.*, 303 U. S. 372, 375–376, declared that "The words 'gross income from the property' as used in the statute governing the allowance for depletion, mean gross income received from the operation of the oil and gas wells by one who has a capital investment therein,—not income from the sale of the oil and gas properties themselves."

Anderson v. *Helvering*, 310 U. S. 404, 408–409, repeated the statement last quoted.

In *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599, 603, the Court said: "The test of the right to depletion is whether the taxpayer has a capital investment in the oil in place which is necessarily reduced as the oil is extracted."

In *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U. S. 25, 32, the Court said: "It seems generally accepted that it is the owner of a capital investment or economic interest in the oil in place who is entitled to the depletion."

Commissioner v. *Southwest Exploration Co.*, 350 U. S. 308, 313, reannounced substantially the rule declared in the *Palmer* case. It said "that a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital.' . . . These two factors, usually considered together, constitute the requirement of 'an economic interest.' "

an economic interest in the oil in place and were therefore entitled to an allowance for depletion against their gross income from that interest.

Five years later, in 1938, the Court in *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, reaffirmed the test laid down in *Palmer* and added: "But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit." 303 U. S., at 367. Applying that principle, the Court held that a processor who, by contracts with the owners of gas and oil wells, had acquired the right to take wet gas from the well heads and to extract and sell the gasoline therefrom, paying the well owners a percentage of the proceeds of such sales, had not acquired an economic interest in the depleting gas in place but only an economic advantage to be derived from the processing operations, and that therefore the income from those operations was not subject to the depletion deduction.

In his first regulations prescribed under the Internal Revenue Act of 1939, the Commissioner adopted almost literally the language we have quoted from *Palmer* and *Bankline* as the tests to be administratively applied in determining what interests in mineral deposits are entitled to the depletion allowance. See Treas. Reg. 103, § 19.23 (m)–1, August 23, 1939. That language, with immaterial changes, has remained in the regulations ever since. During the years here involved, 1942 through 1950, the regulation in force was Treas. Reg. 111, § 29.23 (m)–1, which, in pertinent part, provides:

> "Under [the provisions of §§ 23 (m) and 114] the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by invest-

ment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production . . . ."

Such are the interests that are permitted a deduction for depletion by the statutes as consistently interpreted by this Court and by the Commissioner.

Petitioners do not dispute that these are the controlling principles, but rather they contend that they come within those that allow the deduction. They argue that by their contracts to mine the coal, and particularly by contributing their equipment, organizations and skills to the mining project as required by those contracts, they, in legal effect, made a capital investment in, and thereby acquired an economic interest in, the coal in place, which was depletable by production, and that they are therefore entitled to take the deduction against their gross income derived from those mining operations.

We take a different view. It stands admitted that before and apart from their contracts, petitioners had no investment or interest in the coal in place. Their asserted right to the deduction rests entirely upon their contracts. Is there anything in those contracts to indicate that petitioners made a capital investment in, or acquired an economic interest in, the coal in place, as distinguished from the acquisition of a mere economic advantage to be derived from their mining operations? We think it is quite plain that there is not.

By their contracts, which were completely terminable without cause on short notice, petitioners simply agreed

to provide the equipment and do the work required to strip mine coal from designated lands of the landowners and to deliver the coal to the latter at stated points, and in full consideration for performance of that undertaking the landowners were to pay to petitioners a fixed sum per ton. Surely those agreements do not show or suggest that petitioners actually made any capital investment in the coal in place, or that the landowners were to or actually did in any way surrender to petitioners any part of their capital interest in the coal in place. Petitioners do not factually assert otherwise. Their claim to the contrary is wholly based upon an asserted legal fiction. As stated, they claim that their contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place. But that fiction cannot be indulged here, for it is negated by the facts.

To recapitulate, the asserted fiction is opposed to the facts (1) that petitioners' investments were in their equipment, all of which was movable—not in the coal in place; (2) that their investments in equipment were recoverable through depreciation—not depletion; (3) that the contracts were completely terminable without cause on short notice; (4) that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place; (5) that the coal at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners; (6) that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in *Huss*, agreed to be in "full compensation for the full perform-

ance of all work and for the furnishing of all [labor] and equipment required for the work"; and (7) that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts. The agreement of the landowners to pay a fixed sum per ton for mining and delivering the coal "was a personal covenant and did not purport to grant [petitioners] an interest in the [coal in place]." *Helvering* v. *O'Donnell*, 303 U. S. 370, 372. Surely these facts show that petitioners did not actually make any capital investment in, or acquire any economic interest in, the coal in place, and that they may not fictionally be regarded as having done so.

"Undoubtedly, [petitioners] through [their] contracts obtained an economic advantage from [their] production of the [coal], but that is not sufficient. The controlling fact is that [petitioners] had no interest in the [coal] in place." *Helvering* v. *Bankline Oil Co.*, 303 U. S., at 368. Of course, the parties might have provided in their contracts that petitioners would have some capital interest in the coal in place, but they did not do so—apparently by design. Instead, petitioners simply entered into contracts, terminable without cause on short notice, with the owners of coal-bearing lands to provide the equipment and do the work required to strip mine and deliver coal from those lands, as independent contractors, for fixed unit prices. "[Petitioners thus] bargained for and obtained an economic advantage from the [mining] operations but that advantage or profit did not constitute a depletable interest in the [coal] in place" (*Helvering* v. *O'Donnell*, 303 U. S., at 372), and having "no capital investment in the mineral deposit which suffered depletion, [petitioners are] not entitled to the statutory allowance" (*Helvering* v. *Bankline Oil Co.*, 303 U. S., at 368). The judgments must therefore be

Affirmed.